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Editorial Comment

Property Taxation

The hearings of the Royal Commission on Dominion-Provincial Relations are now drawing to a close but it will be some months before its report is ready. One of the most urgent problems presented to it from every quarter is that of property taxation and the depressing influence which it undoubtedly has had on the building trades and in other directions in municipalities from one end of the Dominion to the other. The subject is a personal one to all property holders, but to read the voluminous briefs presented to the Commission would be a long and tedious task. The editorial committee, therefore, is pleased to be able to publish this month a summary of the briefs by G. R. G. Baker who has been a contributor to these pages on several occasions. The main features of the problem and some of the solutions suggested to the Commission are given in his summary.

The years since Confederation have brought conditions and circumstances entirely different from those existing in 1867. The drift of the rural population to the cities in the anticipation of finding employment in industry, the business cycles with their periods of booms and depressions and the accompanying waves of labour demand and unemployment, the increased extension of social services and

state aid, and the opinion freely expressed of late by the unemployed that the state owes everybody a living — all have brought to municipalities unusually heavy financial burdens and problems, the solution of which appears to become more difficult with each succeeding year.

*The Quality of
Administration*

It is unnecessary to refer here to the many phases of the problem as these have been clearly set forth in Mr. Baker's summary. Neither is any solution offered as this is one of the functions of the Commission. This review of municipal matters, however, affords us an opportunity of referring to one matter in particular respecting the administration of public bodies which has not been given prominence in the briefs and which we believe should be recognized and means for its correction studied.

Much has been said and written recently in favour of the senior governments assuming a large part of the burden of social services. If put into effect such a change would lighten considerably the financial load of municipalities; but the shifting of this burden to the provincial or the federal authorities, as noted by the Citizens' Research Committee, would not be a guarantee of a real and permanent solution of the problem if a council should then consider itself free to extend other services which the municipality could very well do without. This is an important point. We have heard the opinion expressed not once but many times by taxpayers in all parts of Canada—without any intention, it should be added, to disparage or be insensible of the conscientious services generously given by many members of council—that the sorry conditions in which municipalities find themselves today are due in a very considerable measure to inefficient administration. The main charge is that owing to the ease with which funds could be borrowed municipal governments on occasions have disbursed public moneys with too lavish a hand and have embarked upon all sorts of unnecessary public improvements. Such opinions have been offered without equivocation or fear of challenge; and of illustrations cited in support of these contentions there was no lack.

Our readers, we believe, will agree that there is undoubtedly foundation for the charge. At the same time is there not room for inquiring as to where the responsibility

actually lies for the unfortunate conditions in which numerous municipalities today find themselves? Should it be placed on the ever-changing group of individuals who have volunteered to administer municipal affairs in the last score or more years, or are the conditions the result of an absurd system of administration?

Weakness of System As a people we are proud of the country in which we live and we cherish the democratic ideals and principles our forefathers fought for and won. But may we not question if enthusiasm for our much vaunted system has not led us all too often into inept applications of democratic principles? Do not the multiplicity of public self-governing units throughout Canada and their present state of financial embarrassment in large measure furnish an answer? It does not require very much intelligence to see that the system of electing a council annually, with the absence of any provision for continuity in its personnel, cannot possibly lend itself to the fostering of a high degree of responsibility in its members. Complete control over the finances and, within certain limits, the future indebtedness of the municipality belongs to such a body; and between elections the ratepayers are at the mercy of a body of elected representatives whose qualifications for a highly responsible office are hardly ever considered on polling day. Under our present system, then, it depends on the calibre of the council whether the affairs of the municipality will be handled with intelligence and care or in a thoughtless and irresponsible manner.

The financial transactions of the municipalities, towns and cities of today are of such magnitude that these public bodies can be classed with what would be described in the commercial world as "big business." It is reasonable to expect that their affairs are being conducted in a manner becoming any large industrial or financial corporation. Unfortunately this is not so; and herein lies the weakness which we have been endeavouring to emphasize. Nobody can conceive of an industrial concern of any size delegating the management of its affairs to an elected group whose personnel changes annually, whose experience in the realm of finance and business may be a minus quantity, and whose financial investment in the business is negligible. The

reason for this is so evident that further comment seems hardly necessary; but let it be noted that the board of directors of such a concern are men of ability and of wide experience in business, whose interest is not only to have the affairs of the corporation conducted efficiently but also to have a balance of revenue over expenditure with which to pay dividends to its shareholders. To that end it appoints a general manager who is trustworthy and of acknowledged ability, places him in charge and looks to him for the efficient administration of its affairs. Why should not the same principle apply in respect of municipal matters? Some municipalities already have the vision of the municipal-manager plan. Such a system will, we believe, contribute very considerably to the solution of this problem. Let us hope that the time is not too far distant when it will have widespread acceptance.*

Local Borrowing in England

In his summary Mr. Baker made reference to the memorandum of Dr. Jennings of the University of London. As the freedom with which municipalities in Canada could borrow has been one of the chief causes of their undoing, the following observation of Dr. Jennings on conditions in Great Britain cannot but arrest our attention: "Occasionally, Parliament gives direct authorization to borrowing by local authorities. The general powers, however, are all subject to the control of the Minister of Health; that is, no loan, except a temporary overdraft in respect of local taxation which will be forthcoming in the current year, can be raised by a local authority without sanction The control of the Ministry of Health is exercised for several reasons. In the first place, the stocks of the large authorities are trustee securities, and the Ministry thus protects the *cestuis que trust*. It is difficult to say, however, which is cause and which effect. For the Ministry's control is directed, in the second place, to the maintenance of the credit of local authorities. *No local authority has ever defaulted*; every loan has to be repaid by means of a sinking fund within periods laid down by statute or by the Ministry. Consequently, the loans enjoy a high

*As noted in Mr. Baker's summary, in the Maritime provinces the municipal problem has not become so pressing as elsewhere because of the tendency of municipalities there "to cut their coat according to the cloth."

standing, and a local authority can borrow on terms hardly less favourable than the British Government. When gilt-edged were earning $3\frac{1}{4}$ per cent., for instance, local authorities were able to borrow at $3\frac{1}{2}$ per cent. at 101. The knowledge that not only the existing loan but also all future loans will require ministerial sanction convinces borrowers that local authorities' loans are as safe as sterling. Further, the control is exercised as to the application of the funds. Where sanction is sought, the local authority has to present details of the scheme on which the money is to be spent. The Ministry will consider whether the scheme is a good one, whether a better could be devised, whether expenditure on some other service (e.g. a sewage disposal plant rather than a public park) would not be better, whether the authority can afford the interest and sinking fund payments, etc. Moreover, conditions are attached in the interest of honest government. It is prescribed that all contracts shall be put out to tender. The loan sanction is thus a very powerful instrument of control."

There are other aspects of the subject of municipal administration to which we hope to make reference in a later issue.

A Question of Realized Profits

A case of considerable interest to members of the profession, in that it had to do with a question of *realized* profits, came up recently for hearing before the magistrate of a London Police Court. The magistrate's decision has not yet been received; but as the principle involved is an important one, a summary of the case will be published in a coming issue of THE CANADIAN CHARTERED ACCOUNTANT. We are indebted to *The Accountant* (London) for the reports of the hearings.

The case arose through a summons by the chief registrar of Friendly Societies against the English and Scottish Co-operative Property, Mortgage and Investment Society, Limited, being a society registered under the Industrial and Provident Societies Act, alleging that they did unlawfully make a return for the year ended 31st December 1936 which was false in that it wrongfully showed that the Society's transactions for that year resulted in a balance of profit of £8,710 contrary to the provisions of the Act.

It may be stated that there is no allegation of fraud;

the summons is in the nature of a test case to ascertain whether or not proper methods of accounting were used in drawing up the return. The society sold in two portions the freehold of certain property on which blocks of flats were erected and leased the flats from the purchasers for an annual rent of £500 in each case, the term of the lease being 999 years in one case and 99 years in the other. The question to be decided is whether or not the profit from the sale of the freehold could in these circumstances be treated as a *realized* profit. According to the report of the hearings conflicting evidence on the point was given by eminent accountants in Great Britain—which tends to add interest to the case.

*Income Tax
Administration*

Great Britain's experience of many years with the income tax has contributed to the development of an administrative system in which the nation prides itself. An account of the income tax in Great Britain and Northern Ireland written by Roger N. Carter, an authority on the subject, was published in our issue of April 1935; and at our request Mr. Carter has now given an account of the administration of the Income Tax Act which we publish this month.

The reader should keep in mind that the taxpayer in Great Britain has an advantage which does not belong to the taxpayer in this country. There the Act is a full and comprehensive statement of the law of income tax and the majority of the differences of opinion which arise between taxpayers and commissioners concern the literal interpretation of the provisions of the Act and are subject to official adjudication by the courts. According to Mr. Carter the income tax cases reported in the courts now number no less than 1200—a valuable source of reference for the public and for the profession in Great Britain.

In Canada the situation is different. The *Income War Tax Act* is little more than a statement of general principles accompanied by the delegation of considerable legislative authority to the Minister. The bulk of Canadian income tax law from day to day consists of rulings of the Minister, very few of which have ever been published. Unless the citizens of the Dominion are generally informed of the rulings of the Minister, they are to a very considerable degree ignorant of the law under which they are being taxed.

*Quebec
Corporation
Taxation*

For the information of members in the other provinces, we have the privilege of publishing this month the brief on the taxation of corporations recently submitted by the Society of Chartered Accountants of the Province of Quebec to the Taxation Revision Board of that Province.

We shall not attempt to refer to the several matters of the brief, but there is one section that will be of particular interest in other provinces, namely, the reference to the tax on the capital of a corporation. The opinion is held in all the provinces that the imposition of such a tax tends to discourage the investment of capital and, as the brief states, "is such that should a corporation be operating at a loss to such an extent that it has impaired its capital, then the capital tax as presently assessed by the Province of Quebec is a direct charge on the capital of the corporation."

It will also be of interest to readers to know that the profession in the Province of Quebec is represented on the above-mentioned Taxation Board by two of our distinguished members—Messrs. George C. McDonald, Montreal, who is a former President of our Association, and J. Arthur LaRue, Quebec City.

*The Late
George Ussher
Stiff*

As we go to press the sad news reaches us of the sudden passing of George Ussher Stiff of Toronto, a distinguished member of the profession and one whose connections with the Dominion Association date from its earliest days.

In July 1911 the first issue of THE CANADIAN CHARTERED ACCOUNTANT appeared. Few of our readers know that it was due to the interest, efforts and determination of Mr. Stiff, its first Editor, that the Magazine of the profession in Canada was able to function during its early years. Turning to page 1 of volume 1 we find the Editor stating that "The initial steps in any fresh activity are, of necessity, uncertain and hesitating But to those whose interest is hearty, whose desire for success is lasting, there is the certainty of achievement." The success of this publication and the high estimation in which it is held are a tribute to the character and the devoted efforts of its originator and first Editor, George Ussher Stiff!

ACCOUNTS OF A MORTGAGE LOAN COMPANY*

By Irvin T. Hunt, Chartered Accountant,
Winnipeg, Manitoba

ALTHOUGH in recent years there has been but little money offered to the prospective borrower on real property security, the mortgage loan business with all its ramifications is nevertheless one of the largest on the continent today.

In view of this fact, it is surprising that one does not find more published articles on the accounts of mortgage loan companies. In the recording of the transactions of any type of business, general accounting principles apply; but, as in many other businesses, there are in the activities of the mortgage company certain peculiarities to which general principles must be adapted.

No attempt shall be made to give a correct legal definition of a first mortgage. Let it be considered as a charge against real property, secondary only to taxes imposed by an authorized legislative body. In this article, first mortgages only are considered.

Procedure in Granting a Loan

To give a better understanding of the basis for the accounting records maintained we shall deal briefly with the general procedure followed in granting a loan.

The first step is taken by the prospective borrower. He completes an application on an approved form supplied by the lending company. Generally, the information to be given therein would be:

- The amount of loan required,
- The legal and physical description of property which is to constitute the security,
- The information as to improvements thereon,
- The name of registered owner,
- The details of existing encumbrances, if any,
- The purpose of loan, and
- Such other general information as is considered pertinent to the matter of granting the loan.

*This paper was one of two receiving Honourable Mention in The 1937 Essay Competition conducted by *The Canadian Chartered Accountant*.

Upon receiving the completed application, representatives of the lending company take steps to verify the statements contained therein. The fact of ownership is established by search of the title. Such search will reveal also all encumbrances registered against the property. By way of further verification, the security is inspected by a representative of the company, and his report includes an appraised valuation.

The original application, supplemented by all relative verifications and information, is placed before the board of directors of the company for their consideration. When the application has been accepted and the loan approved, the mortgage agreement is drawn up and duly executed. The particulars which form the basis for entries in the records are now available.

A statement of loan is drawn up indicating the amount authorized. The loan, of course, will only be a fraction of the valuation placed upon the security by the inspector. The statement sets out in detail, the costs to the borrower of securing the loan and directions as to whom the money will be paid, and these costs include:

Legal fees for examining the title and drawing the documents,

Land Titles Office fees for searches and registration,
Inspection fee, and

Sundry disbursements.

The net proceeds of the loan may be used to retire certain obligations of the borrower. Under these circumstances, payments are made directly to the creditors. Discharges of encumbrances, if any, on the security are obtained and the new mortgage is registered.

Accounting Records and Transactions

With these preliminary remarks over it is now possible to consider the records required for a clear and complete, yet concise recording of transactions. The books of original entry comprise:

1. Register of cash receipts,
2. Register of loans,
3. Register of cash disbursements—General,

4. General journal, and
5. Annual payment journal.

Each of these records will be examined as to its use, but the discussion of rulings and headings of numbers 1, 3 and 4 will be deferred until other phases of the business have been dealt with.

Register of Cash Receipts—This is, as the name implies, a register for the recording of all cash received and its distribution.

Register of Loans—Herein are recorded all transactions relative to the granting of a new loan. It is a combination of the journal and the cash disbursements register.

Borrowers' costs, as set out in the statement of loan mentioned above, are in part incurred through services rendered by the legal and inspection departments of the mortgage company. To obviate the necessity of issuing cheques to the respective departments to cover such items, the charge to the borrower is made by journal entry. Charges to the borrower for registration fees and sundry items paid will be for actual amounts disbursed. Payment is recorded as a charge to a "Registration Fees" account. This account is cleared by the journal entry setting up the loan account. To illustrate: John Smith has been granted a loan of \$5,000.00. Part of the proceeds will be used to retire an old mortgage on which \$3,500.00 is owing to "A" Company. The balance, after legal fees of \$30.00, inspection fee of \$10.00 and registration fees of \$25.00 are deducted, is to be paid to John Smith to finance improvements.

The necessary journal entry is:

<i>Debit</i>	Loan account	\$5,000.00
<i>Credit</i>	Bank account (cheque to "A" Company)	\$3,500.00
	Bank account (cheque to John Smith)	1,435.00
	Legal fees	30.00
	Inspection fees	10.00
	Registration fees	25.00

ACCOUNTS OF A MORTGAGE LOAN COMPANY

REGISTER OF LOANS									
Date	Loan No.	Particulars	Cheque No.	Bank Cr.	Legal Fees Cr.	Inspection Fees Cr.	Amount Loan	Registration Fees	
								Dr.	Cr.
19—									
Feb. 2		Land Titles Office	206	25 00				25 00	
Feb. 9		"A" Company	260	3500 00					
		John Smith	262	1435 00	30 00	10 00	5000 00		25 00

Accounts for legal fees and inspection fees thus charged to borrowers appear as revenue accounts in the general ledger. The accumulated yearly total in each account is offset against the expenses of operating the respective departments.

The distribution as shown by the illustration provides adequate information and facilitates the accumulation of individual items for the purpose of posting monthly totals to the respective controlling accounts in the general ledger.

Register of Cash Disbursements—General—All disbursements other than those recorded in the register of loans are entered in this register. The ruling and headings for the purpose of distribution will be dealt with later.

General Journal—The general journal is the medium for recording all adjustments other than annual payment transfers, which do not involve actual receipts or disbursements of cash. It may be written up in individual entry form, but a distribution sheet from which postings of monthly totals to the general ledger are made, is readily adaptable. This latter method eliminates much bookkeeping detail.

Annual Payment Journal—Loan principal is repayable generally over a period of years. This plan of repayment is set out in the mortgage agreement and may be on either of two bases. A popular and convenient method is that of amortized payments. Retirement of the debt is effected by a stated number of equal annual payments which include principal and interest. The other method is by repayment of stated amounts of principal each year and payment of interest computed on the unpaid balance.

In either case it is necessary to transfer the amount of annual repayment of principal from the account controlling "Principal Not Yet Due" to that controlling "Principal Due." It is also necessary to set up the annual interest charge to the borrower. To illustrate: In the case of John Smith's loan of \$5,000.00, it is to be repaid over a period of ten years, with interest at 5% per annum. The basis of annual payment is: principal \$500.00 plus interest on the unpaid balance. At the end of the first year the charge to John Smith in the record of debt due by borrowers will be based on the following journal entries:

- | | | |
|------------------|-------------------------|---|
| (1) <i>Debit</i> | "Principal Due" Control | \$500.00 |
| | <i>Credit</i> | "Principal Not Yet Due" Control \$500.00 |

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(2) *Debit* "Interest Due" Control \$250.00
 Credit "Interest Income" \$250.00

These entries will be consolidated on one line in the annual payment journal.

The specimen sheet from this record indicates suitable rulings and headings:

ANNUAL PAYMENT JOURNAL				
Annual Payment Date	Loan Number	Transfer of Principal		Interest Charged
October 1	1	\$500	00	\$250 00
October 1	100	250	00	125 00
Monthly Totals		\$20,050		\$11,225

The monthly totals are posted to the respective controlling accounts in the general ledger, thus:

Debit Principal due\$20,050.00
 Interest due 11,225.00

Credit Principal not due \$20,050.00
 Interest income 11,225.00

Postings of principal transfers and interest charges to the subsidiary ledger accounts are made from this journal.

There are other functions of a mortgage loan company to be considered. Under ideal conditions its business would simply consist of the lending and collecting of money. Such conditions are rare. Borrowers do not always make their loan repayments when due. Insurance policies are allowed to lapse and taxes to fall in arrears. To protect its security the company must advance money in payment of such expenses. These additional advances are charges to the respective accounts and are controlled by a separate account in the general ledger.

In many cases borrowers continue in default of loan

repayments and interest payments. The lending company is then obliged to exercise its privilege under the mortgage agreement of taking title to the property. This may be done through foreclosure proceedings, tax sale proceedings or by voluntary transfer from the registered owner.

Ordinary foreclosure proceedings may be instituted upon continued default in loan repayments. In recent years, due to adverse economic conditions, property owners have had the protection of statutes specially enacted for that purpose. The debtors have the right of appeal to the Boards set up in the various district. An appeal is considered on its merits and the Board before which the case is heard decides whether or not the creditor may proceed against the debtor.

Tax sale proceedings are instituted by the municipality in which the property lies. If, for a stated number of years, taxes have not been paid, the municipal authority has vested in it the right to sell the relative property to recover the amount of taxes owing. A loan company holding a mortgage against such property may purchase the land at tax sale or may later purchase the assignment of the tax sale certificate. The registered owner has a given time within which he has the right to redeem. If he does not avail himself of this opportunity, the tax sale purchaser may take title.

Whatever the method taken to obtain title, the loan company is now the owner of the property. It is not the object of the company, primarily, to own and operate real estate. However, to protect its security, title must be taken and held until a favourable sale may be made. In the meantime there will be expenses of operating to be paid and revenue to be collected. Provision is made in the accounting records for the accommodation of this contingency.

There may be differences of opinion as to the value at which property so acquired should be carried on the books. Sale value at the time of acquisition is a conservative basis of valuation. When the transfer is made from the loan account to the real estate account it will be necessary to adjust the amount. The adjustment may be, and generally is, a reduction from the balance owing on the loan to the value placed upon the property. The difference is charged to an account for profits and losses on acquisition and dis-

position of real estate. On the other hand the adjustment may be an increase in the amount at which the loan is carried in order to write the account up to sale value. The increase will be credited to the same account to which decreases are charged. At the end of the fiscal year the balance in the "Real Estate Profits and Losses" account is written off to the relative reserve account which is a provision against possible losses on real estate.

Real estate acquired by the company through foreclosure or other proceedings is sold as and when favourable opportunities arise. A sale may be for cash or on an agreement extending over a period of years: if for cash, the necessary adjustments to close the real estate ledger account are made and title transferred to the purchaser; if on an agreement to purchase, with payments spread over a number of years, the need for a different type of record arises. This record is an agreement ledger.

The amount and terms of sale are agreed upon as between the purchaser and the board of directors of the company. The relative document is drawn up and duly executed. An account is opened in the agreements ledger. The heading of the ledger sheet will show details as to the name and address of the purchaser, the legal description of the property and the terms of sale.

There are three types of subsidiary ledgers essential to the recording of a correct division of transactions of a mortgage loan company, and these ledgers are controlled in the general ledger by ten separate controlling accounts. The ledgers with their respective subdivisions are:

Loan Ledger—(Record of original loans)

Principal not due
Principal due
Interest
Additional advances

Real Estate Ledger—(Record of property acquired)

Capital (Book value)
Operating

Agreements Ledger—(Real estate sold on agreement)

Principal not due
Principal due
Interest
Additional advances.

The headings of accounts in the loan and agreements Ledgers should show:

Name and address of borrower or purchaser,
Legal description of property,
Terms of mortgage or purchase agreement, and
Such other information as is necessary for convenience in reference.

The headings of the real estate ledger sheets need indicate only the legal description of the property and convenient references.

The rulings of the cash receipts and cash disbursements registers and general journal may now be indicated.

Cash Receipts Register — Cash received may be applied on:

Loan principal, interest or additional advances,
Agreement principal, interest or additional advances,
Real estate capital or operating, and
Sundry

On page 437 is a specimen of the receipts sheet.

It may be desirable for the sake of convenience to provide further columns for distribution of items which would come under "General."

Cash Disbursements Register (General)—Cash disbursed may be applied on:

Loan—Additional advances,
Agreement—Additional advances,
Real estate operating expenses, and
Various classifications of administrative expenses as shown in form illustrated on page 438.

ACCOUNTS OF A MORTGAGE LOAN COMPANY

REGISTER OF CASH RECEIPTS

[illegible]

[illegible]

[illegible][illegible]

General Journal—There are many controlling accounts affected by the variety of journal entries which will arise in the ordinary course of business. The record is more easily handled if the sheets are ruled so as to have one complete sheet made up of both leaves of the open book. Convenient ruling appears in the illustration on page 439.

In the foregoing the accounting records essential to a complete recording of all transactions of a mortgage loan company have been dealt with. In addition there will be found numerous memorandum records, index books and files. These vary with the different systems of handling office routine.

Audit

Let the above records now be considered from the standpoint of audit. The basis of any audit is the verification of the receipt of goods and cash and the disposition thereof. In the case of a mortgage loan company, the documents which represent the security may be considered as goods.

The extent of the audit in connection with receipts of cash will depend, as usual, upon whether or not the system of handling funds affords a satisfactory internal check. In any event the auditor should strongly recommend that he be permitted to conduct an independent verification of mortgage and agreement accounts by circularization.

Disbursements fall into two categories. Disbursements are made on account of new loans granted and on account of ordinary operating expenses. The two types differ only in respect of authorization. Generally the paying out of moneys to defray ordinary operating expenses is left to the discretion of the official who directs general business routine. There must be on record, however, authorization by the board of directors for the disbursement of funds expended on account of new loans granted. Such authorization is usually incorporated in the minutes of meetings of the board of directors.

The powers of the manager in the matter of making decisions with respect to expenditure of moneys should be clearly outlined. Any items not falling within the bounds of the authority so delegated to him should receive consideration of the board of directors as a body, and the result of such consideration should appear in the minutes of the meetings.

With this in mind, an audit of all expenditures resolves itself into a verification, from supporting vouchers, of amounts expended and proper authority therefor.

A further step must be taken in connection with new loans granted. It is important to examine the mortgages and relative documents to ascertain that:

The agreement is with the registered owner of the property,

The legal description of the property as contained therein is correct,

The terms as set out in the agreement are in accordance with those authorized,

The agreement is duly executed, and that

There is satisfactory evidence of registration of the document as a first charge against the property.

The sources of information essential to verification of non-cash items, as they appear in the general journal, include all other accounting records as well as the files and the board minutes. There can be no established rule to cover these items; each must be considered separately, the amounts verified and satisfactory evidence of authority obtained. Items in this record will include:

Sundry adjustments,

Transfers from loan to real estate account where title has been obtained, (Certificate of title will be on file and should be examined), and

Transfers from real estate to agreements account, upon the sale of owned property.

Revenue is obtained from interest on money loaned and agreements for sale of property and from rentals received on owned real estate. In accounting for interest revenue a check is made of interest charges as entered in the annual payment journal. It is left to the discretion of the auditor as to whether the check be complete or merely a test. The result of a partial verification generally would indicate whether more need be done.

Accounting for rental revenue presents somewhat more of a problem. If the property is leased on a basis of straight cash rental, the solution is simple. However, the rented property may be farm land leased on a share-crop basis.

Here it is necessary to obtain a statement of all crop grown on the land in question and to see that it is accounted for according to the terms of the lease. This information is contained in the respective files.

Rental of property may be set on a basis of percentage of business done and there are probably many other methods used in setting rental fees. The lease agreements will indicate the amount to be collected, and these agreements constitute the starting point for verification of all rental revenue.

There are many points of minor detail which must be covered in the audit of a mortgage loan company as in that of any other business. These do not differ in principle from those encountered in other audits, and may be covered in the original plan of audit and as they arise during the audit.

The matters of organization and capitalization have been omitted from the foregoing. Other than slight differences in statutory requirements, there is no variation from regular practice in this respect.

This article is intended merely as a general survey of the type of accounts used by a mortgage loan company and the transactions leading up to their use. There may be many variations in the methods employed by mortgage loan companies in the recording of transactions, but there will not be many variations in the type of transactions recorded. The choice of method is simply a matter of adaptation; the system as outlined here has proven satisfactory.

THE INCIDENCE OF REAL ESTATE TAXES

By George R. G. Baker, Toronto

FROM coast to coast since last November, the Royal Commission on Dominion-Provincial Relations has been hearing the statement reiterated again and again, "the burden of taxation on real estate is too heavy." From Halifax to Vancouver, real estate boards, property owners' associations, chambers of commerce, municipal organizations, teachers' organizations, school trustee associations and the cities and towns themselves have all said with one voice, "we must relieve real estate from its terrific burden of taxation."

To examine the submissions of these bodies is the purpose of this article, not to arrive at any definite solution, for that is now the job of the Commission, and no one begrudges it to them, but to learn the reasons for the claims they make and some of the remedies they have advanced. In order to effect this purpose, quotations from the various briefs are liberally employed.

The System

The method of taxation of real estate is familiar to everyone, whether a taxpayer or not, so that it requires little description. Briefly, it may be described as a levy of a certain rate on the capital value of the land and buildings to be taxed, according to an assessment which may range anywhere from forty to one hundred per cent. of the actual or market value. This revenue source is allocated almost exclusively to municipalities, although in some provinces it is also made to serve as a supplementary source of revenue to the Province, usually through the agency of the municipalities.

Legislative Background—The legislative background of the tax has been described thus: "The basis of assessment, the levying of rates, the manner of tax collection, the rates of penalties and discounts, the methods of sale for non-payment of taxes, and such matters as exemptions, limits of taxation, local improvement and special taxation are all governed by provincial legislation."¹

That the real estate tax should be appropriated to the use of municipalities seems only natural, when we consider

¹Dominion Mortgage & Investments Association Submission, Part II, page 66.

the basis of their origin described as follows: "These urban municipalities were erected as such because of a desire by owners of properties comprising these communities to provide collectively for their respective properties, certain services which they could not individually provide."²

Accordingly, it has been argued, "That having become so erected into urban units, the properties included therein, became properly taxable for the cost of such services and for no other, and

"That services to persons as apart from property, that do not contribute to the utility, increment or safety of property, are not properly a function of municipal administration and are not properly a charge on property."²

Responsibility for Social Services—Whatever the original intention in this respect, we find a development that changed the whole course of municipal finance and taxation, when a demand grew up for one social service after another and the Privy Council interpreted the British North America Act in such a way that the responsibility of providing for them was placed on the shoulders of the Provinces. This, notwithstanding, that the Provincial powers of taxation were limited to indirect taxation within the Province while the Dominion powers extended to any mode or system of taxation whatever.

The Provinces, however, went ahead and established various social services imposing a great part of the cost on their creation, the municipalities, because it was considered that their direct contact with the problems involved rendered them better able to deal with them.

This development has now reached a stage in Ontario, for example, where, "Real estate taxation by the municipality provides funds in whole or in part for all of the following purposes:

- (a) Unemployment relief and other forms of relief to persons,
(Note: Up until 1937 this classification also included widows and old age pensions)
- (b) Education including public libraries,
- (c) Hospitals (other than mental) and health services,
- (d) Fire and police departments and jails,
- (e) Local improvements such as sewers, sidewalks and

²Union of Alberta Municipalities, page 1.

pavements and also street widening and traffic control,

(f) Parks and recreation,

(g) General municipal maintenance and government."³

Increasing Strain on System—As the amount required for such purposes increases, it becomes necessary to raise a greater revenue by this mode of taxation, the rate of the tax increases and its weaknesses become more apparent. "The great weakness of the system of taxation on the capital value of real estate is two-fold. On the one hand it tends to reduce capital value and on the other hand by that very fact destroys its own base."⁴

This principle has been further illustrated in the following:

"The law of increased rates of taxation and diminishing returns always operates in relation to excessive and crushing taxation. In Vancouver we find this exemplified to a dangerous extent. It is particularly apparent in properties held for investment. Every time annual taxes are raised one dollar, capital values drop \$20, on the basis that one dollar is the annual return at 5% per annum on \$20."⁵ The following quotations are also referred to with approval: "Land values may be destroyed by taxation, and, other things being equal, every change in taxation results in a proportional change in land values."—Prof. T. Ely; "The increasing taxation on 'capital value' is certainly a most effective method of cheapening land, and of obtaining its nationalization or municipalization."—Prof. A. B. Clark.⁵

Tax rates alone are not a criterion of the burden, for the incidence of the tax will also depend upon the general level of assessment, the average income then prevailing of the taxpayers, and the standard of service which the individual municipality provides.

"The weight of taxation on real estate is not uniform as between municipalities. This is the case not only because of the application of varying mill rates and the different percentage of gross assessment made taxable, but also because gross assessment represents in the main only the local assessor's conception of value. The determination of value

³Ontario Association of Real Estate Boards, page 6.

⁴The Regina Board of Trade, page 5.

⁵Vancouver Real Estate Exchange, page 4.

is at best a difficult question, which fact is recognized in practice by seeking to make whatever value is determined upon equitable as between different properties. It follows that the amount of taxes expressed in dollars and cents is the true standard by means of which the burden of taxation on individual properties in a locality can be weighed in comparison with that in another locality."⁶

Other Burdens—In many cases, the municipality is made the instrument for the imposition of an additional tax on real estate for the benefit of provincial activities. For example, in Saskatchewan municipalities collect on the Province's behalf a public revenue tax, a wild lands tax and a tuberculosis sanatoria tax; and in Alberta, a social services tax, and a wild lands tax.

Levies are also made for school boards, police commissions and parks and library boards all of whom may have separate spending authority. In Winnipeg, for example, in 1936 the following percentages of the total income of the City was collected for the various authorities: for the purposes of the city council itself 50.1%, for the parks board, police commission and library board, 8.2%, for the school board 28.7%, for the water district 6.9%, and for the Province (mainly for old age pensions, child welfare and hospitalization) 6.1%. Only with respect to one-half of the total income did the city council have any control as to the amount required and the way in which it should be spent.

This situation is general throughout the Dominion, although for Winnipeg, a certain amount of relief was obtained by legislation passed at the 1938 sittings of the Legislature, when the city was given the right to pare down the estimates of the parks board and police commission, although an attempt to obtain the same power with respect to the school board resulted in a mere right to request revision of estimates followed by a right to refer the matter to arbitration.

In connection with the cost of schools, the situation is aggravated by the fact that the educational standards are set by the Province, and the municipalities must conform to these standards in order to earn certain Provincial grants, even though they be hard put to it to find the necessary money.

The Provincial contribution for education purposes is

⁶Reference as in footnote 1, page 66 thereof.

relatively small. In Alberta, the contribution of the Provincial government to the cost of schools in Calgary and Edmonton is only 7%, leaving these cities to pay the balance of 93% substantially out of the income from real estate taxation.

Unemployment Relief—Since the beginning of the depression, one of the major causes of difficulty in the financing of municipalities, has been due to the increasing costs of unemployment relief which they have been called upon to pay. The burden has been borne by the Dominion, Provincial and Municipal governments in varying proportions throughout Canada, but to the municipalities it has been a heavy load indeed, bringing some of them to their very knees.

One of the unfortunate features of this situation has been the fact that municipalities on the outskirts of larger cities, with a large labouring class of population, and a relatively small income from taxation, have had the largest number of their taxpayers out of work and on the relief rolls, while wealthier municipalities in fashionable suburban districts have a relatively small labouring class and, accordingly, few are on the relief rolls. The difficulty of apportioning the responsibility for unemployment relief payments by municipalities, on an equitable basis, is at once apparent.

The burden of relief payments may be appreciated when it is stated that in the City of Hamilton in the worst days of the depression 8,600 families out of 35,500 were on relief. In the City of Lethbridge 42% of the taxes collected were for unemployment relief purposes. In 1937, the City of Toronto collected \$3,000,000 for this purpose.

Resistance of System to Burden—There are many critics of the present system of real estate taxation, although it is not without its advocates. The March 1938 issue of the Bulletin of the United States National Tax Association, whose membership is composed of those interested in taxation and public finance, including many prominent tax officials, carries this quotation as part of a leading article: "The general property tax represented in large part by a tax on real estate has been the only source of revenue that has tided governments over the depression, both from the point of view of producing revenue and from that of furnishing security for borrowings. In too many instances during the depression the tax on real estate has represented

a capital levy as is witnessed by the increasing amount that has moved into governmental ownership through tax titles or into the hands of others by foreclosure. Despite long and vociferous criticism of the real estate tax, at least it has demonstrated it can keep a government alive longer than any other form of taxation devised.

"No one quite knows why real estate has been able to contribute so much without being confiscated, but certainly the depression has shown that the property tax can never be abandoned because due to its immobility it continues to produce tax revenue despite taxes exceeding income.

"Every state faces now the requirement of readjusting its tax structure to reduce the tax on real estate and permit restoration of values. What the wreckage will show in respect to values that have been lost forever may never be definitely known. It seems now to be established that the property tax is the only one capable of supporting the government at levels to which we have become accustomed."

• **Criticism of System**—The most frequent criticism of the system is that the tax is inequitable as applied to one class of taxpayer, the real estate owner. The following is used by way of illustration: "Let me present this proposition. A man and his wife live in, say, the town of Lindsay where the tax rate is approximately 45 mills. They have for investment, say, \$20,000. If they invest this sum in securities at, say, 5%, their income will be \$1,000 yearly while their exemption from income tax is \$2,000. It follows they would pay nothing toward the country's tax bill that the owner of real estate does not pay in addition to his municipal taxes. If this couple were to invest \$20,000 in Lindsay real estate on the basis of actual value at the current tax rate of approximately 45 mills, they would pay \$900 yearly in taxation before having anything for themselves.

"This example would apply equally well to every other municipality in Canada. If the \$20,000 is invested in real estate it will create industry and employment. Moreover, the owner will have a definite financial stake in the country. Do you consider that our existing taxation set-up is promoting a return to prosperity or retarding it?"^a

^aThe March 1938 issue of the Bulletin of the United States National Tax Association, page 1.

^b*The Financial Post*, January 23, 1937, Ex-Mayor Cecil G. Frost, M.P.P., of Lindsay, Ontario.

Mr. Frost does not mention the 5% or 7% on his investment that the owner of property has made in the past over and above the amount of the tax. Then, too, while income from real estate has gone down, so has income from securities. It would now be very difficult to buy a security yielding 5% without incurring a risk of capital loss. The average rate would be nearer 3½%.

One might also mention that if common stocks had been purchased, the experience of the investor would have been very similar to that of the real estate owner. The income of the company in whose stock an investment was made might not have been sufficient to pay more than taxes on the business and the interest on a bond mortgage, just as the owner of real estate might not be able to do much more than pay taxes and the interest on the mortgage out of the revenues derived from rents. However, if the company is well managed and producing goods for which public demand continues, a profit will be made. In the same way, if a real estate property is well managed and of a type and location for which public demand persists, rents will be sufficient to earn a reasonable income for the owner.

Present System Supported—A reply to this argument was advanced in an article by a former city solicitor in Nova Scotia from which these words are taken: "The fact that theirs is the hand by which taxes on land are paid into the city treasury, and also that the average man seems incapable of recognizing any economic truth not directly in front of his nose, enable owners of real estate to contend that they bear a most undue share of municipal burdens.

"Mr. Frost illustrates what he evidently considers the great injustice suffered at present by owners of real estate, by comparing two residents of Lindsay, one of whom invests \$20,000 in real estate in the city, and he invests an equal amount in some other form of investment. The former, according to Mr. Frost, contributes \$900 yearly to the exchequer of the city—the latter not one cent. One must wonder if this is a true picture why anyone should invest in real estate in Lindsay or in any other municipality, yet they do. And, of course, the obvious explanation is that the owner of real estate, except in so far as he is himself an occupier, merely collects the city's taxes as part of his rents, which he fixes at a rate high enough to

cover taxes, insurance, repairs and a reasonable return on the investment. The man who does not invest in real estate nevertheless, if he occupies a house, pays in the same way as if he owned it—only he pays through the hands of his landlord.”

Mr. Bell does not give very much consideration to the fact that in recent years rents have been very slow to increase. Although taxes have been climbing steadily every year for several years, rents did not increase sufficiently to take care of them; due to other factors they dropped. According to the Dominion Bureau of Statistics, a rent level of 100 in 1926 climbed to a peak of 105.9 in 1930, then steadily dropped until 1934 when it stood at 80.1, from which point it has slowly climbed until in October of 1937 it reached a level of 89. There has been a definite lag in the tendency of rent to follow taxes as they go up and similarly, one might be so cynical as to suggest, there would also be a lag in the tendency of rents to go down if taxes were reduced sufficiently to return a generous revenue to real estate owners.

Benefits of Present System — Mr. Bell continues with three reasons why he thinks municipal taxation should be imposed almost wholly on real estate.

1. “First, urban real property is the only kind of property which derives its value solely from the city. Agricultural land is different, it is an instrument of production. But urban realty owes its values solely to the fact that it is part of the area of the city, and can be used for purposes of business or habitation. . . .”
2. “Second, no other form of taxation approaches taxation on real estate in its ability to diffuse itself over the whole community. If, in the illustration already quoted from Mr. Frost, one of the investors was not himself the occupant of a house in Lindsay but occupied a room in a lodging house and took his meals in a restaurant he would not escape taxes. His would not be the hand that paid them to the city, but from whom would the keepers of the lodging house and the restaurant obtain the money wherewith to pay their taxes but from their customers?

“It is so with every other expenditure made in the city. It is impossible to spend a dollar in the city without, sooner

^oThe Financial Post, February 13, 1937, Letter to editor from Mr. F. H. Bell, Halifax, N.S.

or later, it may be through many hands, some fraction of it finding its way to the civic treasury. Of no other form of taxation is that even approximately true. It is curious that everyone realizes this diffusion of the incidence of other forms of taxation—notably of custom and excise duties, and yet fails to realize it in the form of taxes on real property.

"Third, and finally, a reason of practical rather than theoretical consideration, but nevertheless of enormous importance. No other system enables a city properly to budget its expenditures. Any properly managed city should so provide for these that there should be little room for either surplus or deficit. The expenditures of a city are almost wholly controllable, and can be estimated with great exactness in advance. The sources from which the revenue to meet them is to be obtained by taxation should be equally exact. Both the total amount required and the amount to be contributed by each taxpayer should be defined as exactly as possible. Further there should be as little room as possible for failure to collect the estimated amounts. With no system is this even approximately possible except by taxation on real property. It varies little in value, it cannot run away. It is immaterial whether the owner at the time of assessment continues to own it or not. The tax lien attaches and the property remains liable. Every other source of taxation is liable to such uncertainty both as to the amount collectible and possibility of collection as to render proper budgeting and accounting impossible."¹⁰ 3.

Then Mr. Bell puts his finger on what most people now realize to be the cause of the whole situation.

"I must not be understood as underrating the burden of present taxation on the owners of real property. As that burden falls primarily on them, and as it is their property which is held responsible for payment of the taxes, they have a real grievance. But the root of the trouble is not the tax system but the excessive amount of municipal taxation."

Formerly taxpayers were accustomed to petition their local council to make greater expenditures for specific services, but now realization of the situation, that has been precipitated as a result of such expenditures, has caused them to reverse the process and ask council not to make

¹⁰Reference as in footnote 9.

greater expenditures, though they still find it hard to deny themselves any part of the expensive services they now take for granted.

Conditions Resulting from Existing System

The general result of the existing system of real estate taxation has been summarized in a statement widely quoted:

"1. The duties and responsibilities of municipalities have increased without a proportionate increase in the power to raise the revenue necessary to meet their new obligations;

"2. Having regard to these increasing duties and responsibilities, real property, the principal source of municipal revenue, is no longer an adequate basis of taxation;

"3. Declining revenues accompanying diminished assessments and increased rates have necessitated a greater resort to borrowing, thereby increasing still further the charge against real property and discouraging new construction and home ownership;

"4. Debt charges and the increasing cost of social services and particularly of unemployment relief are absorbing a continually increasing proportion of annual revenues and are tending to paralyze normal municipal services;

"5. Forced economies in current municipal services are resulting in a huge accumulation of deferred maintenance and expansion.

"6. Having regard to the heavy burden of debt charges, further economies in ordinary expenditures can afford no material relief to the taxpayers of the municipalities."¹¹

Increase in Expenditures—The tremendous increase in the expenditures of the City of Winnipeg, as shown in the following table, indicates the trend of affairs:

CITY EXPENDITURES PER CAPITA¹²

	1911	1936
Social services	1.29	15.18
Education	3.59	13.28
Local improvement & water distribution	1.62	2.75
Highways	3.61	3.70
Police protection	5.89	6.99
General government	1.74	2.10
All other services	6.83	10.37
	<u>24.57</u>	<u>54.37</u>

¹¹National Construction Council, page 3, statement of Prof. H. Carl Goldenberg, McGill University.

¹²Winnipeg Real Estate Board, page 7.

It is interesting to note the tremendous increase in the per capita cost of social services and education, due in the case of the former to the number and kind of services, especially unemployment relief, that have been added as municipal responsibilities and in the case of the latter in great measure to the increased cost of equipment and teaching staff employed.

The percentage of total municipal taxes collected from real estate taxation is large in every city. In Winnipeg, 92% are from this source. In Regina a large revenue is derived from their municipal utilities, so that the percentage is only 70%. Edmonton similarly derives a large revenue from this source, but few municipalities are so favourably situated.

A better idea of the burden may be obtained by calculating the average tax payable by each property owner. In Winnipeg, it has been estimated at \$295, in Edmonton \$212, and in Vancouver \$226.

Property Owners in Minority — One of the significant features of the situation is the fact that the real estate owners do not represent a majority of the population, although they are held responsible for the largest percentage of the taxes collected. In Winnipeg, property owners represent less than one-third of the adult population. The incidence of the tax, however, is indicated by the shrinkage in the number of real estate owners. In Edmonton, out of 85,470 residents, in 1936 only 14,023 were taxpayers. This is less than half the number in 1920, although the population has increased during the period. Toronto, during the ten years between 1926 and 1936 suffered a decrease in the number of dwellings occupied by owners of 5,891, while in the same period tenant occupied dwellings increased by 12,703.

Tax Arrears—The extent to which property owners have failed to carry their properties during the depression is shown by the accumulation of arrears of taxes, although in recent years municipalities have been collecting an amount which is beginning to approach the equivalent of their annual tax levy. It may be expected, therefore, that arrears will not greatly increase. The figures now, however, are rather startling. In Winnipeg by the end of 1936, they had reached \$12,082,722, including the amount

owing against acquired property, which is equal to nearly two years' yield of their general property tax. In Vancouver they amount to \$10,000,000 or nearly one-year's taxes on all properties. In Calgary, \$4,091,693 is owing.

Property Reversions — A more alarming trend is the number of cases where properties have reverted to the municipality for taxes and title has been acquired thereto. In the case of vacant lands, the municipality loses a source of income as soon as this takes place and a large proportion of tax sale properties are vacant lands.

The total assessed value of lands which had reverted to the City of Winnipeg at the end of 1936 was \$6,946,367, with the result that the City owned 52.92% of all the vacant lots in the municipality. In Vancouver, \$15,000,000 worth of properties have reverted to the City. In the City of North Vancouver, 67.20% of the lots valued at 40.61% of the total assessment have reverted. In the District of North Vancouver, the position is even worse, where 73.61% of the properties valued at 50.06% of the value of all properties have reverted. In Burnaby 30% in number and 39% in value have fallen to the municipality. In the City of Victoria out of 18,774 parcels, 5,246 or nearly 30% have reverted to the City by reason of tax default.

The position in Edmonton is that 56,743 parcels, valued at \$10,279,032, out of a total of 110,000 parcels have been acquired for arrears of taxes. In Calgary, 75,000 parcels have been acquired as well as 3,000 acres of unsubdivided land, all of which were assessed at \$5,249,000 and constituted 67% of the original City and 50% of the total assessment. Lethbridge has acquired over 50% of its lots by tax sale proceedings.

One can imagine the cumulative effect of this situation on the housing problem. It has been said that the high real estate tax is one of the three most important deterrents to new building. High labour and building costs and general uncertainty of the future stability of income are the other two.

Proportion of Income for Taxes—Figures compiled from authoritative sources for a survey recently conducted with respect to the Prairie Provinces, to show the incidence of real estate taxes on urban properties in relation to income earned from the properties taxed, gave the following result: In Manitoba the percentage of the tax to the gross

annual return from some 700 properties (mostly in Winnipeg) was 37.36%; in Saskatchewan the percentage was 45.46%, with respect to some 680 properties (mostly in Regina); and in Alberta the percentage arrived at was 43.34% of the gross annual return from some 230 properties (mostly in Calgary and Edmonton).

No mention has been so far made of conditions in the Province of Quebec because at the time of writing the Royal Commission had not yet received representations in that Province. No mention has been made of Maritime conditions either, although the Commission has heard representations both in Nova Scotia and Prince Edward Island. In Quebec the situation would be very similar to that in the Provinces mentioned, but in the Maritimes the problem is not so pressing, because of the very careful way in which their municipalities watch their expenditures, and of the tendency to "cut their coat according to the cloth." This commendable attitude has placed them in a much better position than municipalities in other provinces, who have embarked on improvident spending orgies, with the result that a municipal default in the Maritimes is almost unheard of.

The Remedy

With so many minds directed to the same problem, it would be surprising if a number of different solutions were not offered. Some of the measures suggested are not a complete solution but rather a palliative which will enable municipalities to carry on with the same system of taxation under a less burdensome rate.

Tax on Productive Value—Dealing first with those suggestions which involve a change in the whole system, we find that the adoption of the English system for the taxation of real estate is the most popular proposal.

"The costs of government, being recurrent expenditures, should be met out of national income and not out of national capital; and property owners should contribute only out of the productive value of property. . . ."¹³

The following explanation is given of the English system, and it may be noted that it is not the actual rental value that is used as the basis, but the hypothetical normal value: "The Commission is, of course, aware that in Eng-

¹³Winnipeg Real Estate Board, page 2.

land real property is assessed every three [five] years on the basis of what it may be expected to rent for. In case it is vacant for a certain period, the owner applies for exoneration from the tax and receives it. This principle is carried so far that the owner of a seven-storey building may apply for a separate rating on each floor, and if three are idle and four rented he is exonerated from the three floors' tax and pays the tax only on the four floors."¹⁴

The English system has been adopted in Australia and South Africa, but the only recognition we give to it in this country is in the vacancy allowance such as the City of Toronto grants, and the business tax levy in vogue in such cities as Calgary and Winnipeg, where the tax is based on the rental value of the property occupied instead of the capital value. The vacancy allowance in Toronto is a refund of the proportional tax on the building alone, for one-half the period of vacancy, although no allowance is made on local improvement or school taxes only on the general rates. This arrangement as to a vacancy allowance is not in general use, however, by other cities.

Benefits of English System—Dr. W. Ivor Jennings of the University of London, an expert on financial matters between the central and municipal governments, was in Ottawa recently, and while there discussed with members of the Royal Commission and their research staff the benefits of the English system. He stated that the English method did away with the municipalities taking over the land for taxes; and arrears of taxes, he said, became only a small problem. The occupier and not the owner pays the tax under that system, so that where the property is rented, it cannot fall into the hands of the municipality. Where the owner is the occupier, collection is made from his personal property, instead of the real estate, because there is no lien against the land.

Unoccupied property is not taxed in England which gives rise to the criticism that it encourages the holding of property for speculative purposes. This would be a greater objection here, where there is much vacant land, than in England where there is little vacant land. Other objections are that it encourages overcrowding, which equally applies to our own system; has little relation to services received, just as our system has not; and finally

¹⁴Property Owners' Association of Calgary, page 12.

that it is too inflexible to provide for steadily expanding services. This is probably the most valid criticism, but imagine a system under which there were no tax sales!

However, it is doubtful whether the English system, if adopted, would give the relief expected of it by property owners, generally, because vacant lands, poorly developed lands, factory lands and unoccupied improved properties are relieved in whole or in part of the burden of tax, with the result that highly developed properties carry a greater burden. The burden on improved property is greater, the burden on unimproved properties is less. In this respect, our own system is perhaps to be preferred. There is not the same tendency, however, in the English system to destroy the tax base.

The Single Tax—The English system for the taxation of real estate dates back to the reign of Elizabeth, but it was only some sixty years ago that Henry George wrote his famous book, "Progress and Poverty," in which he advocated a single tax for all purposes on land values only. Under such a system, the tax is imposed upon the "unearned increment" in land value arising, say, from an improved site-value which occurs when a city is built around or near the property in question. It is argued that the owner has done nothing to create this additional value, and the state should, therefore, appropriate this "economic rent," leaving the buildings or improvements free of taxation, because they are something the owner has created and paid for. "The chief element in economic rent always is the services provided at public expense. The economic rent, over and above the amount of the land tax paid, is in the nature of a free gift from the public to the landowner. Taxes upon land, therefore, have complete ethical justification so long as they do not exceed one hundred per cent. of the economic rent."¹⁵

This viewpoint has probably had a profound effect upon the present Canadian and American real estate tax systems, in that smaller dwelling houses are allowed substantial exemptions from taxation on the buildings themselves, with the result that in those cases the land bears the greatest part of the tax. Then, too, in some cities, buildings are only assessed at a percentage of their value. For example, in Calgary and Edmonton, the assessment rate for dwellings

¹⁵The Single Tax Association of Canada, page 11.

is only 50%, and for business premises 60%, while in Lethbridge and Medicine Hat the rate is 66 2/3% of the estimated value of all buildings.

Experiences in Alberta—Indeed the Cities of Calgary and Edmonton have tried the single tax system in its entirety with the following result:

"Previous to 1918 the Cities of Edmonton and Calgary assessed real property on the basis of the single tax, buildings and improvements being exempt. As an indication of its inflationary character, the assessment of land in Edmonton in 1914 stood at \$191,283,970. In the same year the land assessment in Calgary stood at \$180,000,000. These values reflect the peak of the real estate boom. By 1937, as a result of progressive reductions, Edmonton's land assessment had shrunk to \$24,018,515 and Calgary's to \$23,241,410. The process of deflation has not yet ceased.

"In 1918 the single tax principle was abandoned by these cities, and their charters now direct that 'land shall be assessed at their fair actual value,' and buildings and improvements at from 50% to 100% of value. . . ."^{1a}

The Province of Alberta itself levies a tax on single tax principles, known as the unearned increment tax, at the rate of 10% (until this year 5%) of the increased selling value of the land over the price paid at the time of its purchase, which is levied at the time of registration of the deed of transfer in the Land Titles Office. This has not, however, been a very remunerative source of revenue, and in the year ending March 31, 1937, it amounted to only \$15,758.30, according to the Public Accounts published by the Province of Alberta.

There is a great deal of evidence to suggest that except in boom times there is little of an unearned increment upon which levy may be made.

"Studies have recently been made in England on the basis of returns for income tax purposes 'which suggest that even under the English system of local rates, resulting as already shown in much lighter tax burdens on landownership, there is strong ground for believing that there has been in the past thirty years no economic return from the mere ownership of land of the character described as economic rent and constituting the source of unearned increment.

^{1a}Cities of Alberta, page 5.

"When it is remembered that the degree of urban development is greater in England than it is in Canada then one is led to conclude that, other things being equal, there ought to be a greater unearned increment factor in English landownership than in Canadian. The studies referred to indicate, however, that whereas in 1910 there was a positive return attributable to land as distinguished from improvements amounting to £49 millions, in 1931, after making provision for returns on the improvements to land and for depreciation, there was a loss chargeable to land account of £11 millions, a decline in twenty-one years of £60 millions, or roughly \$300 millions, in annual site value. If similar data were available in respect of Canadian land we are confident they would show enormously greater economic sacrifices arising from the ownership of land. . . .'"¹⁷

The sponsors of the single tax idea do not now claim that its adoption would do away with the necessity of levying every other tax, because they recognize that the tremendous increase in the cost of government in all jurisdictions would make such revenue source inadequate. However, they do claim many partial successes throughout the world, and recommend that it be used by the municipalities as an exclusive tax, by the Provinces instead of taxes on business and motorists, and by the Dominion in place of the sales tax.

Tax on Produce—Under the heading of an alternative system, we may place the Agricultural Produce Tax Act which was passed by the Legislature in Alberta this spring. It will apply only in rural areas and will be levied at the rate of 7% of all products of the farm, payable in kind, either directly or through dealers who purchase from the farmer. The Act is not to come into force until proclamation and after its validity has been tested by the Supreme Court of Alberta.

It is obvious that a tax of 7% on the gross production of the farm would be equal to a very much higher one on the net return to the farmer from his operations. Accordingly, it has met with a storm of criticism from farmers throughout the Province and there is a strong likelihood that it will never be proclaimed. The organization necessary to administer it would be considerable, and the expense

¹⁷Property Owners' Association of Toronto, page 11.

and difficulty of marketing the produce collected would seem to render it unworkable.

Cancelling Tax Exemptions—Prominent among the suggestions for providing additional revenue which would result in an alleviation of the burden of taxes on present real estate taxpayers is that for cancellation of exemptions now granted from municipal taxation. Religious and educational institutions are wholly exempt from real estate taxation for lands in their actual use and, although in the past there have been societies organized for the purpose of opposing such exemptions, there is little criticism in this respect at the present time. The force of criticism is directed mostly toward the exemption of Crown lands belonging to senior governments, especially where such lands are utilized for the carrying on of business in competition with private enterprise, and the exemption of public utilities.

"The theory that because a property stands in the name of H. M. The King, either by right of the Federal or Provincial governments, it should be exempt from payment for the municipal services rendered to it, is outworn. Such a theory might have been tenable when both the revenues and expenditures were dealt with, directly or indirectly, by a central government, but it has long since become inapplicable. There can be no justification for the individual property owners of Vancouver being called on to pay increased taxes in respect of their own properties because other properties are used by the Federal or Provincial governments for collecting revenue or performing general administrative and other services, which increase expenditures without contributing to the cost of them. In a number of cases, the purposes for which the buildings are used are in direct competition with local property owners."¹⁸

In Halifax and Vancouver considerable areas of government docks are exempt from taxation. In Halifax and other centres, armouries and other buildings used for military purposes are not taxed. Throughout Canada various government buildings are also free and in the Western Provinces soldier settlement lands, until recently, were tax free in the hands of the Soldier Settlement Board, although now a grant is made in lieu of taxes as a payment in aid of municipal services.

Exemption of Public Utilities—The exemption of public

¹⁸Reference as in footnote 5, page 8 thereof.

utilities and other businesses deprives municipalities from access to a substantial source of revenue. It is a particularly irritating fact to many municipalities that the Province derives a profitable revenue from liquor stores yet pays no taxes on land the Province owns, upon which stores are located or no business tax by reason of their operations. Railways have been granted generous immunities in the past from the payment of taxes in the Western Provinces, and the Intercolonial railway is able to take advantage of the exemption of the Crown in this respect, in the City of Halifax its Eastern terminus.

In England, it may be noted, property actually occupied by the Crown is exempt, but in lieu of taxes the Crown makes a contribution to municipal revenues. Municipally owned utilities pay their share of taxes with other taxpayers and the revenue from the operations of local utilities is said to be about 37% of the total municipal revenue.*

The municipalities themselves take exception to the extensive exemptions for Crown properties, but it is the taxpayer who objects to exemptions for public utilities. In Toronto it is said the property exempted under this head in 1937 was valued at nearly \$16,000,000 and the loss of tax revenue on land and buildings alone, exclusive of business tax, was \$570,000. "It is of course evident that a public utility enjoying immunity from taxation has an initial advantage against privately owned competitors and, other things being equal, will be able to reduce its rates by the extent to which it is not required to pay the taxes which would be charged against its competitor. To that extent the public is deceived as to the cost of the services rendered by a publicly owned utility. To that extent also the general body of taxpayers are burdened with the costs of a subsidy to the consumers of the utility."¹⁹

Very illuminating with respect to exempted property is a table (XXVII) set forth in the brief of the Citizens' Research Institute of Canada, showing the percentage exempted of taxable property in the more important cities of Canada in 1933. Halifax stood highest at 82% and Toronto almost the lowest at 17.7%. The percentage for Montreal was 33.2%. The assessed value of such property in Halifax was \$39,832,000, in Toronto it was \$154,517,000,

¹⁹Property Owners' Association of Toronto, page 24.

only exceeded by Montreal, where exempted properties were assessed at \$317,150,000.

In some Canadian cities, of course, notably Edmonton and Regina, substantial revenues are derived from municipally owned public utilities and in this way the property owner is relieved from paying a higher rate. In most centres, however, municipal utilities are operated at cost or with a deficit which the municipality makes up. This spring Winnipeg, in dire need of additional revenue, was given permission by special legislation to raise water rates for extra revenue. This, of course, only amounts to a further tax but it has this virtue that it is levied on a wider tax base than the real estate tax, inasmuch as it includes the large section of the population who are renters of property.

Fixing Tax Limits—It has often been suggested that property owners should be protected against high taxation by the fixing of a limitation by statute to the rate of taxation levied. The Property Owners' Association of Calgary recommended as follows:

"That a statutory limitation of the levy made on real property be established on the basis of a rate not in excess of 3% of its full value, and that any demands on the part of the City for a higher rate be subject to the approval of a Provincial Tax Commission."²⁰

This method of controlling municipal taxes has already been adopted in various municipalities, for example, in Winnipeg and Vancouver. In the former city, power was given by the legislature this spring to go beyond the legal limit of 12 mills for controllable expenditures, while in the latter city, the requirements of their budget for 1938 necessitated the levying of a tax rate right up to the legal limit imposed.

This expedient has been described as a form of taxpayers' strike, used to force reluctant provincial legislatures to resort to other revenue in order to avert the collapse of local government. Many criticise the rigidity of such a system and point to the fact that it has usually failed to achieve its purpose. When assessments are climbing in good times, a greater amount of taxes may safely be levied under the limit imposed, but when assessments are falling the amount realized under the same limit is

²⁰Property Owners' Association of Calgary, page 24.

smaller and the taxpayer finds that a false sense of security was engendered by the tax rate limitation and unnecessary spending encouraged thereby.

Tax limit schemes lack any constructive features and may have an adverse effect on municipal credit. The only security for investors in municipal securities is the tax levy, and if this is to be restricted so that an insufficient amount may be available for servicing debt, the investment is not attractive. It would be far better to restrict the accumulation of debt.

In many Provinces the borrowing powers of municipalities are restricted by statute, but there has been a lamentable tendency for them to seek special legislation in particular instances to circumvent the purpose of the restrictive Act.

Grants from Senior Governments—A very logical way of reducing the burden of real estate taxes would seem to be the shifting of it to other shoulders. This could be accomplished either by means of grants from the senior governments, the taking over by senior governments of part of the services municipalities now provide, or the making available to municipalities of other forms of taxation.

In England a gradual evolution has begun in the financing of local governments resulting in the making of substantial grants by the central government. Dr. W. Ivor Jennings, to whom reference has already been made, states that grants from this source represent 31% of local government revenue, and that over half the cost of education is so contributed. The average financial aid contributed by Canadian provinces and other governments to education is shown in the following table:²¹

Grants

	Average
Ontario	11.5%
Quebec	6.4%
New Brunswick	14.7%
Nova Scotia	13.1%
Manitoba	13.5%
Saskatchewan	17.6%
Alberta	13.3%
British Columbia	32.9%
Prince Edward Island	59.1%

²¹City of Toronto and Ontario Mayors' Association, page 16.

Government Aid

The British Isles	50% to 56%
South Africa	75% to 99%

In most cases the suggestion that senior governments should assume a greater share of social services is not limited to the costs of education but extends to unemployment relief, old age pensions and mothers' allowances as well. In the case of the last two, Ontario now assumes the whole cost, as does British Columbia in the case of mothers' allowances. Of course both the Dominion and Provincial governments pay a large share of unemployment relief, although municipalities still find their share a very heavy burden.

Relating Source and Purpose of Tax—Property owners generally would limit the tax upon real estate to an amount sufficient to cover the cost of beneficial services. This overlooks the fact that whether or not it was the original use and purpose of such taxes, they have now become simply a source of revenue for government. No one ever suggests that income taxes be levied only for services beneficial to sources from which income is derived.

There are, of course, other reasons why real estate should not be as heavily taxed as it is.

"Why should all City services be charged, as to 92 per cent., against property owners, who form less than one-third of the adult population? In particular, why should all social services be so charged? And why should the heavy costs of education, to the extent shown, be imposed exclusively on property owners?

"If it be held that taxes should be levied in relation to benefit received, there is no logic or equity in such a distribution. There are other services, such as fire and police protection, or the maintenance of highways, which may confer more direct or greater benefit on property owners than on other classes, but the effects even of these services reach all classes.

"If it be not benefits conferred, but ability to pay that should be the basis of tax distribution, then we submit that the ownership of property is not in itself a fair measure of general ability, and over a whole class this measure cannot be justly applied on the scale at present in effect.

"In any case, it is clear that the intolerable situation

which has developed in Winnipeg is due more to increases in the costs of social services and of education than to any other causes. The proper redistribution of the burden of these services is therefore among the most obvious and most urgent problems."²²

Widening The Tax Base—An obvious method of relief would seem to be available in a widening of the tax base; the imposition of municipal income taxes, sales taxes, poll taxes, renters' taxes, personal property taxes and many others which the ingenuity of various taxing authorities have devised. All of these have been used by one or other municipality with greater or less success, but none of them approach in efficiency the real estate tax itself. Most of them are expensive to administer and frequently fall far short of conferring the benefit they are intended to bestow.

There is this also to consider. "It is a fallacy, however, to think that real estate is affected only by municipal taxation. If other taxation leads to reduced net incomes in the hands of the people, reduced local taxation on real estate may be accompanied by reduced revenues of real estate."²³

This, of course, applies equally to a shifting of the tax burden to senior governments: "If, following the removal of the cost of social services in whole or part from real estate, either the provinces or the municipalities levied additional taxes to meet the cost of social services, such as wage taxes or sales taxes, investments in real property might be in no better plight than at present. . . . The shifting of the cost of the greater part of social services to the Dominion and the provinces and of a large part of the costs of education to the provinces, is desirable; but unless this shifting is also accompanied by a control of public expenditure, little or no ultimate advantage will accrue to real estate."²⁴

Conclusion

The foregoing has doubtless given some idea of the magnitude of the problem before the Rowell Commission which will be winding up its hearings at Ottawa in September. The solution will be difficult to find, involving as

²²Winnipeg Real Estate Board, page 8.

²³Citizens' Research Institute, page 96.

²⁴Ibid., page 95.

it does a consideration of the fact that whatever system of taxation is adopted the taxes themselves must ultimately come out of the pockets of the same group of citizens. Shift the burden as you may, it will always rest in the last analysis on the general public itself. We may be assured, however, that the question will receive the very earnest consideration of the Commission, and the high quality of its personnel leads us to hope that a recommendation of real value will be made, pointing the way to a satisfactory solution.

**THE ADMINISTRATION OF THE INCOME TAX IN
GREAT BRITAIN AND NORTHERN IRELAND**
in Regard to the Determination of Income Tax Liability

By Roger N. Carter, F.C.A., Manchester, England

FOLLOWING the article which I wrote in April 1935, some points of detail in the administration of the income tax may be interesting to your readers.

As many may not have the article by them, it will perhaps be useful even to repeat some of the points contained therein.

The Scheme of the Act

The scheme of the Act is:

- (1) A return of income by the taxpayer to the Inspector (about May in each year);
- (2) A review of the return by the Inspector of Taxes;
- (3) An assessment by the Additional Commissioners or the Special Commissioners (about September);
- (4) An appeal against the assessment if objected to;
- (5) Payment of tax: (a) By two instalments on 1st January and 1st July in the case of tax on "earned" income, i.e. salaries, etc., or profits of a business, accruing to individuals or partnerships; (b) In one sum on 1st January in practically all other cases (including profits of a limited company).

This scheme has been continued in force since the tax was re-introduced in 1842 up to the present time; item 5 is comparatively modern.

Basis of Assessment

In the case of a business or profession the basis of assessment for any year is the profit made for one year up to the date in the previous year to which the accounts have been made up. Thus even if accounts are made up annually to 30th April the assessment for 1937-38 would be on the profit made in the year to 30th April 1936. The assessment for any year may and probably will, therefore, be entirely different from the profits of the year to which the assessment relates, though the scheme works fairly in the long run.

Special provisions apply to the beginning and ending years. In principle, the tax for the first year is chargeable on the actual profits made, the tax for the second year is chargeable on the profits of one year from the setting up of the business, and the tax for the third year is chargeable on the profit made in the previous year. There is, however, an option to the taxpayer to have the tax for the second and third years (both, but not one only) charged on the actual profits made in those fiscal years.

Similarly, the tax for the last year is chargeable on the actual profits made in the period from 6th April to the date of cessation, and tax for the penultimate year is chargeable on the actual profit made in that year if that profit is greater than the amount assessed. The taxpayer has no similar right to relief if the profits of the penultimate year are less than the assessment. Theoretically the above named option at the commencement is supposed to obviate any possible injustice in assessing the last year but one.

In view of the above, it is the practice in accountants' offices—assuming they deal with their clients' income tax—to render the accounts for the year to the inspector of taxes as soon as they have been completed. Thus, if a client's accounts are made up for the year to 31st October 1937, these will form the basis for assessment for the year 1938-39. The accountant having sent these in to the inspector with his "computation" of the assessment, the inspector examines them, asks any questions which he considers necessary, and, speaking generally, agrees a figure for assessment with the accountant. When the form is served for the return, early in April, nothing remains but to put in the agreed figure. This plan spreads the work

over the year, and is thus of immense convenience both to the accountant and the Revenue authorities.

The Administration

The tax is placed under the direction and management of the Commissioners of Inland Revenue (who are, incidentally, *ex officio* special commissioners for the tax for the purpose of signing documents); and in the application of the whole system of notices, assessments and appeals, the interest of the Revenue is secured by the action of officers termed, in the original Act, Surveyors of Taxes, but now Inspectors of Taxes. These are Revenue officers paid by fixed salaries. Their duties are numerous and practical; they attend the meetings of the district commissioners, compare the returns of the taxpayers with the estimate of the assessor, and ascertain their correctness, (in the case of property tax assessments by reference to the valuation for the poor rate and other information they may obtain).

As to Schedule D assessments, if any question arises on the accounts furnished, e.g. as to whether certain items of repairs are of a revenue or capital nature, the question is gone into and in most cases an agreement is come to. If agreement is found to be impossible on any particular item, then it is understood that the accountant considers $\text{£}x$ to be the correct liability, and the inspector considers $\text{£}x + y$ to be correct. When the time comes the accountant completes the form for his client inserting $\text{£}x$ in the return, and the inspector submits $\text{£}x + y$ to the commissioners, who, speaking generally, accordingly assess at $\text{£}x + y$. On receipt of the notices of assessment an appeal is lodged, and it is understood that the only items in dispute are those represented by $\text{£}y$. There is, however, a statutory requirement that the grounds of objection shall be specified in the notice of appeal.

The party aggrieved then appears before the commissioners (special or general, at his option) with his representative, and the point is argued.

The appeal having been heard, the next authority is the King's Bench Division of the High Court. There is no appeal from local (general) to special commissioners.

The commissioners for the general purposes of the Income Tax (briefly described as general commissioners) are

appointed by the Land Tax commissioners. Their principal function is to make assessments and hear appeals.

All Justices of the Peace are *ex officio* Land Tax commissioners and others are named in a Names Act. Giving evidence before the 1919 Commission, Sir Thomas Collins, the then Chief Inspector of Taxes, stated that the last Names Act was passed in 1906. It is not known how gentlemen get their names into the Names Act!

The Land Tax Acts had been in force for a century prior to the Income Tax. Under the Land Tax Acts the county was the unit for administration purposes and a separate body of Land Tax commissioners was nominated for each county. When the Income Tax was introduced in 1798, general commissioners were appointed (unpaid), from amongst or by the Land Tax commissioners for various areas (called divisions). In his evidence before the Royal Commission, Sir Thomas Collins stated that there were then 725 bodies of general commissioners (5,600 in all). By the Income Tax Act there is a property qualification of about £200 per annum to render a person eligible as a general commissioner.

The general commissioners appoint the "Additional Commissioners" who must have a property qualification of about £100 per annum. The additional commissioners *make* assessments *en bloc* at the instigation of their respective inspectors of taxes, all the investigation work having been accomplished before the list is prepared.

The above commissioners are quite independent of the commissioners of Inland Revenue, and represent a system of theoretical self-taxation at rates fixed by parliament, the Inland Revenue officers, headed by the Board of Inland Revenue, being watch-dogs who have now become administrators to see that the tax assessed reaches the Treasury. The special commissioners are appointed by the Crown, but are not Inland Revenue officials, though their staff is composed of such officials. They were devised to meet the objections of taxpayers who did not like their affairs to be known to the local commissioners, who might in some cases be trade rivals.

Appeals

As already indicated the general date for sending out the usual notices of assessment is in September in each

year (additional notices of assessment being sent out as occasion demands).

The taxpayer is to give notice of appeal, if dissatisfied with the assessment, within twenty-one days. He may appeal to:

- (a) The general commissioners, or
- (b) The special commissioners.

The former are local gentlemen of position and they act voluntarily. The latter are paid officials appointed by the Crown with expert knowledge of the Income Tax. As a consequence, appeals on technical points are usually made to the special commissioners, and appeals on assessments based on estimated figures (in the absence of evidence of actual profits) are generally made to the general commissioners.

On an appeal, if the commissioners wish to consult together privately, both the taxpayer and the Inland Revenue representative leave the room. Their decision on a question of fact is final.

Either side, if dissatisfied with the decision of the commissioners on a point of law, can give immediate notice to have a case stated and to have the case heard by the High Court. An appeal lies from there to the Court of Appeal and finally to the House of Lords.

The question whether the point in dispute is one of *law* or one of *fact* is itself a point of law. Further, the Court sometimes holds that even on a question of fact the commissioners could not on the evidence have reasonably come to the conclusion they reached, which to the lay mind seems a legal fiction coming perilously near upsetting a decision given on a question of fact.

The public are not "behind the scenes" in regard to the operations of the Revenue authorities, but the experience of accountants is that if the point at issue has been decided in the courts, the inspector will be chary of asking the commissioners to sign an assessment which is demonstrably not in accordance with the decision. But if the Revenue propose to dispute the application of the decision, they will instruct the inspector to ask the commissioners to sign an assessment based on their views. If the exact point has been decided in the House of Lords no such action would be taken—the decision is binding, and nothing but an Act

of Parliament can alter it. But if the precise point has not been to the House of Lords the inspector may be instructed to ask the commissioners to sign an assessment in order that the Revenue may take the point in dispute to the House of Lords. A case cannot go direct from a decision of the commissioners to the House of Lords, and whether it is the taxpayer or the Revenue who seek to upset a decision of, say, the Court of Appeal the case must go through:—

District Commissioners (General or Special)
King's Bench Division and Court of Appeal
(In Scotland the Court of Session)

with the knowledge that the party appealing will lose every time because of previous decisions on the point, and the point at issue will only be the subject of real argument in the House of Lords in an endeavour to get a decision overruling the previous decisions of the King's Bench or Court of Appeal (on the point at issue).

Naturally, many cases are similar though not identical, and either side may appeal to the Court and endeavour to show that his case is not identical with one decided against him. On identity being demonstrated, any court will ordinarily give a like decision to that in any other court of the same standing, and must do so as regards a decision by a superior court. Thus the High Court must follow a decision of the Court of Appeal or of the House of Lords; and will follow the decision given in any other High Court case, either in England or Northern Ireland, and, generally in Scotland.

It is only decisions of the High Court, the Court of Appeal (Court of Session in Scotland), and the House of Lords which are public property. Decisions of the commissioners, and of the recorder in Northern Ireland, are quite private. The decisions of one body of local commissioners may vary from those of another on the same point, as there is no official *liaison* between them, and they are not experts.

The special commissioners are expert in the law of Income Tax, and impartial judges as between taxpayer and Revenue, though appointed by the Crown. There are only eight of them, and besides hearing appeals in London fairly continuously, they go on circuit from place to place in the Provinces and Northern Ireland (two sitting together as a court). They are in touch with each other, and, speak-

ing generally, they would give the same decision on a given point, an obviously convenient practice. Of course there are instances where the commissioners differ among themselves, just as Judges may differ in their interpretation of the words of an Act of Parliament, but where it is known (by private conference, etc.) that the special commissioners have given a particular decision on a point, it is futile for another accountant to hope to obtain a different decision from them on that point. He can only pursue the matter with the idea of appealing (if the point be one of law) to the Court, knowing he will be defeated before the commissioners. Practice shows that these various (private) decisions before the commissioners become, in many cases, known to the local inspectors, who attach a certain importance to them. Also, the inspectors are in constant receipt of the views of the chief inspector and the Board of Inland Revenue on important points arising in practice, or on the precise effect of a legal decision, and the inspectors are held responsible for carrying out those views.

Naturally, the views of the authorities change from time to time, sometimes, I suppose, influenced by individual opinions at headquarters where senior officials of necessity change from time to time, and sometimes by decisions in the courts. As an illustration of the latter point, it is assumed that the authorities were advised by their legal department that amounts received under a "Loss of Profits" policy were not assessable, for they stated specifically that such items were not to be brought into the accounts for taxation purposes. Accordingly, inspectors disallowed premiums on such policies as deductions for Schedule D unless the party agreed to bring in for taxation any recoveries. But when the case of *Rex v. British Columbia Fir & Cedar Lumber Co. Ltd.* (Privy Council 1932) decided that such items were chargeable, the authorities changed their practice. Recoveries became chargeable and premiums were allowed, and the Institute of Chartered Accountants obtained a concession for the allowance of premiums so paid and disallowed for six years back.

The Acts are administered by the courts by reference to the exact letter of the law. The income tax cases reported in the courts reach about 1,200. These reports are available to the public. Over and over again judges have called attention to the fact that there cannot be an

equitable construction of a section of the Act, though it may appear that the Act does not really express what was intended by the legislation.

In many cases inspectors are allowed discretion in applying the law to specific cases, but *as a principle* they have instructions how to deal with various matters. These instructions (which are confined to the Income Tax service) run into thousands of paragraphs.

It is beyond question that the methods employed in the administration of the law of income tax in the United Kingdom have reached a very high standard of efficiency and uniformity, and could be followed with confidence anywhere.

About twenty years ago it was found that inspectors were not always fully aware of current and recent High Court decisions on Income Tax, and since then those decisions and a short report of the cases have been notified to them by the prompt issue of special leaflets. These leaflets have just (March 1938) been made available for issue to the general public for one guinea per annum; but any instructions issued by the Inland Revenue to their officers, and the voluminous books of instructions in which the machinery of practice and administration is detailed, are confidential and are not accessible to the public.

QUEBEC NOTES

Memorandum Respecting Provincial Taxation

On 20th April last the Society of Chartered Accountants of the Province of Quebec submitted the following brief to the Taxation Revision Board of the Province of Quebec.—*Editor.*

To the Chairman and Members,
The Taxation Revision Board of the
Province of Quebec.

Gentlemen:

In submitting the following memorandum and suggestions in regard to the Corporation Tax Acts in the Province of Quebec, we wish to assure you of our earnest desire to be of assistance to your commission.

The practice of our profession brings before us the viewpoint both of the taxpayer and of the Tax Administration Department of the Government, and we would ask that you give consideration to certain suggestions which, in our opinion, would permit of the corporation taxes being more equitably borne than at present and which would, at the same time, assist the Government in their administration of the Acts.

We have not dealt in any way with the rates of taxation as this of necessity is a matter of governmental policy. It should however be borne in mind that a continued increase in the rates of taxation may bring into play the law of diminishing returns which has been found in the case of certain taxes to be a very effective law for the reduction of yield therefrom.

We have not attempted to deal with the Statute paragraph by paragraph nor to put our recommendation in the form of proposed amendments to the Statute, as we feel that the incorporation of such changes as your Commission may see fit to suggest to the Government is a matter to be dealt with by members of the legal profession. We would, however, appreciate the opportunity of reviewing with representatives of the Government any suggested amendments to the Statute or Regulations, so that we may give them the benefit of our experience as to the accounting interpretation to be placed on the legal language.

Province of Quebec Corporation Tax Act

The act to impose taxes upon corporations doing busi-

ness in the Province of Quebec, other than those for which there is special legislation, deals with two annual taxes, one based on the "paid up capital" of the Company and the other based on the profits of the Company.

These are dealt with separately hereafter—

TAX ON PAID UP CAPITAL

Present Act:

This tax is imposed on all corporations "doing business in the Province" and "carrying on any undertaking, trade or business therein." These latter expressions are stated to mean exercising *any* corporate rights, powers or objects in the Province.

The taking of orders by means of travellers or mail is not interpreted as doing business in the Province providing the company for which the orders are taken has no agent, representative, vendor, salesman on commission or employee resident in the Province and no place of business in the Province.

"Paid up capital" is so defined that it includes capital, surplus, reserves (except depreciation), sums borrowed by issue of bonds or securities and all sums advanced or loaned by any other company, excluding banks. A deduction is allowed for goodwill under certain regulations as laid down by the Provincial Treasurer.

The regulations issued by the Treasurer control the exclusion of goodwill based on—

- (1) Whether a business is stable or unstable and
- (2) The class of business, amplified as to whether the business is a quasi-monopoly or monopoly.

The Act provides for a deduction of deficits from "paid up capital" only in the case of companies having no par value stock and limits the deduction to a point which after deducting the deficit from the amount paid up on such no par value capital stock leaves a remainder of not less than \$5.00 per share.

The Act gives power to the Lieutenant-Governor-in-Council to allow such a reduction in the tax, for a fixed or undetermined period, as he may deem just to the following companies—

- (a) Having head office outside of Province and doing business in the Province.

- (b) Having head office in the Province but the *greater part* of its assets outside the Province.
- (c) Having head office in the Province but only *holding* the stocks and bonds and other securities of other incorporated companies.

The objections to the present Act may be summarized as under:

(1) Definition of Paid up Capital—This permits of evident inequalities, since if moneys are borrowed from banks or individuals the corporation's paid up capital does not include such borrowed moneys, whereas if the moneys are borrowed from corporations or the public such borrowings are included as capital.

The Act does not specifically include "purchase money obligations" but the administration interprets the words "sums borrowed" to include such obligations although a strict interpretation could not be said to so include such class of obligation.

(2) The deduction of goodwill is based upon regulations which are indefinite, difficult of interpretation and arbitrary in effect.

(3) Deduction of deficits is only allowed to companies having no par value stock and then only to a limited extent. It is evident that if a corporation has incurred a deficit its capital must be impaired to the extent of the deficit irrespective of whether the issued capital stock of the company has par value or no par value.

(4) The granting of discretionary powers to the Lieutenant-Governor-in-Council results in taxation by order-in-council with no redress instead of taxation by statute. This would appear undesirable both from the administrative viewpoint of the Government and far more so from the viewpoint of the taxpayer, since the latter has no method of knowing what his tax will be from year to year nor any legal right of appeal from orders-in-council issued pursuant to the Statute.

(5) The discretionary powers in respect of companies having head offices in the Province and a majority of its assets outside the Province would appear to be inequitable in that a company *with its head office in the Province* and having 50%, or slightly less than 50%, of its assets outside the Province is not entitled to any reduction, whereas if a similar company has 51% of its assets outside the Province

it is entitled to ask for special consideration by the Lieutenant-Governor-in-Council. In the case of a large corporation doing a Dominion-wide business it may have a large amount of assets outside the Province, but such amount might be a percentage far less than 50% of the whole, in which case it is assessed a tax by the Province of Quebec on such assets without the Province notwithstanding that it may also be similarly taxed on the same assets in other Provinces, with the result it suffers duplicate taxation.

(6) The application of discretionary power to be exercised in respect of "holding companies" is not clear as there is no definition of the word "holding" and the interpretation is left entirely to the administration, with the result that constant arguments must arise as to when a company ceases to be a "holding" and is classified as a "trading" company.

(7) In determining the amount of paid up capital subject to tax no provision is made for the elimination therefrom of investments.

Suggestions:

The capital tax as presently assessed has departed from the form which it took originally when the *Corporation Tax Act* first came into being in 1882, at which time the tax was in the nature of a license rather than a tax on capital. It is felt that everything should be done to endeavour to attract industry to the Province and therefore that the annual tax to be collected from a corporation in order that it may carry on business in the Province *should be done away with* and the only tax from a corporation be measured by the profits the corporation makes. The present tax on capital is such that should a corporation be operating at a loss to such an extent that it has impaired its capital then the capital tax as presently assessed by the Province of Quebec is a direct charge on the capital of the corporation.

It does not come within the scope of this brief to suggest substitute taxes and if it is felt by your Board that the capital tax cannot be eliminated owing to loss of revenue and inability to replace such loss from other sources we would suggest that a rate of tax and the basis of computation of "paid up capital" to which such rate should be applied be agreed upon by all Provinces; this tax be

collected by the National Revenue Department of the Dominion Government and that the tax so collected be allocated to Provinces in proportion to the sales in each Province of each company from whom the tax is collected. This would result in a saving to the taxpayer by the elimination of the cost of preparing a separate return for every Provincial jurisdiction presently levying a tax, would also avoid the payment of a capital tax on more than 100% of the taxpayer's capital, and further would eliminate the multiple costs of collection now being incurred through each government having its own collection and examination department. A simple example of paying capital tax on an amount in excess of 100% of capital is—

Industrial Company with Head Office in Quebec

Capital as presently determined under Act	\$1,000,000.00
Assets in Quebec (no investments)	\$ 700,000.00
Sales	5,000,000.00
Sales in Quebec	\$3,000,000.00
Sales in Ontario	2,000,000.00
Capital subject to tax in Quebec	\$1,000,000.00
Capital subject to tax in Ontario	400,000.00
Total capital subjected to tax	\$1,400,000.00
Which exceeds actual capital by	\$400,000.00

Since there may be difficulties in having all Provincial Governments agree to a uniform basis of tax and allocation thereof and also agree to the Dominion Government collecting the tax, the following suggestions are made to endeavour to make the present Act more equitable, easier of administration, simpler for the taxpayer to compute the tax payable, avoidance of unnecessary work and expense in filing returns and a reduction in cost of collection to the Province—

I. "Paid up capital" should be the proprietors' equity (that is to say, paid in capital, surplus realized less realized deficits) plus any moneys loaned to the corporation by the proprietor either directly or indirectly and funded debt.

In the case of companies, other than those whose business is the holding of or dealing in investments or both, which own *investments in the shares of other companies* there shall be deducted from the capital, as defined above, a proportion thereof arrived at by applying the percentage that such investments at book values bear to the total assets of the company at book value.

II. Any deduction from Capital in respect of Goodwill should not be considered unless a surplus should have arisen as a result of setting up Goodwill. Such surplus would be automatically eliminated since it would not be a realized surplus (See Suggestion I).

III. Discretionary power to the Lieutenant-Governor-in-Council or any others should be dispensed with and the tax assessed pursuant to Statute amplified by Regulations if deemed necessary.

IV. Capital of company as determined by Suggestion I should be allocated for all companies irrespective of whether their head office is within or without the Province, excepting corporations incorporated in jurisdiction outside of Canada, on the basis of the relation that fixed assets within the Province and sales within the Province bear to total property and total sales.

This method if used by the Province of Quebec would however result in duplication of tax on capital in certain cases owing to the present basis used in other Provinces, more particularly where a company is engaged in business both in Quebec and Ontario. Therefore if Ontario cannot be persuaded that the method proposed is the more equitable, it would appear necessary, in order to avoid hardships on Quebec corporations, to resort to an allocation of capital based on sales.

Sales to be allocated to the jurisdiction in which the offer to sell or buy is accepted, such acceptance is considered to have taken place in the jurisdiction where the purchaser resides if the vendor has its head office, a branch office, store, office or other similar place of business in such jurisdiction or has therein a resident agent, representative, salesman on commission or employee, in all other cases the acceptance is deemed to be in the jurisdiction in which the company has its head office or principal place of business.

V. Special rate of tax to be assessed against companies

whose business is only that of owning securities of other corporations, provided that said companies do not sell securities to or buy securities from the public, other than their own shares or bonds. The rate to be a fixed amount per million of capital as determined by Suggestion I, with a maximum of, say \$1,500.00.

VI. In the case of corporations incorporated under jurisdictions outside of Canada, doing business in Quebec, the capital subject to tax should be an amount equivalent to the assets of such corporation within the Province.

VII. A Board of Appeal should be created, to which the taxpayer could appeal if he considered the assessment by the Revenue Department to be excessive, the only appeal from the decisions of the Board to be to the Courts. The Board should consist of three to be appointed by the Lieutenant-Governor-in-Council for a period of not less than one year, the retiring members to be eligible for reappointment. The chairman of the Board to be a Judge; civil servants not to be eligible for appointment to the Board.

TAX ON PROFITS

Present Act:

The Act provides for a tax of $2\frac{1}{2}\%$ of the profits of any corporation received in the Province when their revenues are derived from investments and of the profits made in the Province when they are derived from other sources, in both cases after deduction of expenses.

The Act further provides for the deduction of a provision for depreciation and depletion as allowed by the Provincial Treasurer and further provides that the decision of the Provincial Treasurer shall be final and conclusive.

The Act further provides that the Provincial Treasurer may disallow as a deduction from profits the whole or any part of any salary, bonus, commission or directors' fees which he may consider in his opinion in excess of what is reasonable for the services performed.

The Act further provides for the Lieutenant-Governor-in-Council allowing such reduction of taxes as he may deem just to a corporation or an incorporated company having its head office in the Province but doing no business therein other than that of holding the stock, debentures, and other securities of other incorporated companies.

The Treasurer has issued certain instructions and reg-

ulations, more particularly pertaining to reserves for bad debts, reserve for depreciation, disallowances of reserves, disallowances of salaries, commissions, etc., profits received from investments and profits from other sources.

The objections to the present Act may be briefly summarized as follows:

(1) There is no definite method laid down in the Act for the purpose of defining the profits *made* in the Province but the following regulation was issued by the Provincial Treasurer—

Such profits are made in the Province of Quebec if the offer to sell or to buy is accepted therein and such acceptance is considered to have taken place in the Province of Quebec, I—although the vendor has its head office or its principal place of business for Canada outside of the Province of Quebec, when the purchaser resides in the Province of Quebec and the vendor has in the Province of Quebec a branch, store, office or other similar place of business or has therein a resident agent, representative, vendor, salesman on commission or employee, or, II—when the vendor has its head office or its principal place of business for Canada in the Province of Quebec, and the purchaser resides outside of the Province of Quebec, provided the vendor has no branch, store, office or other similar place of business in the province, state or country where the purchaser resides.

(2) The Act does not specifically exclude capital gains or capital losses in determining the profits of a company subject to tax, although inferentially from regulations issued by the Treasurer this would seem to be the case.

(3) There is nothing in the Act to determine the basis of segregation of the profits within and without the Province, when profits arise both from within and without the Province.

(4) The determination of salaries, bonuses, commissions and directors' fees which may be disallowed as deductions from profits is covered by regulation and would appear to be entirely within the discretion of the Provincial Treasurer.

Suggestions:

It would appear to be advantageous to both the taxpayer as well as the various Governmental bodies involved if the Profits Tax imposed by the various Provinces, including the Province of Quebec, were assessed and collected

by the Dominion Government at the same time as that Government collects its own income tax. This would avoid the necessity of preparing a multiplicity of forms and arrangements could be made for a segregation of sales, as a basis for the allocation of profits as between various jurisdictions, to be attached to the Dominion Income Tax Return.

In the event of there being difficulties in arranging for the above procedure it might be reasonable to suggest that the Quebec Government should place the collection of its profits tax in the hands of the Dominion Government and thus avoid to some extent the unnecessary amount of labour involved in corporations preparing numerous tax returns for governmental bodies as well as the duplicate expense incurred by governments in the collection of their taxes. If however the above arrangements could not be made then it would appear that certain changes should be made in the Act in order to facilitate the collection of the taxes, as well as to facilitate the payment of the tax by the taxpayer.

1. The profits as determined by the corporation for Dominion tax purposes should be submitted under oath to the Provincial authorities and accepted by them as the basis for taxation.

II. There should be an allocation of sales to determine the proportion of profits taxable in the various Provincial jurisdictions. The allocation of these sales should be to the jurisdiction in which the offer to sell or buy is accepted, such acceptance is considered to have taken place in the jurisdiction where the purchaser resides if the vendor has its head office, a branch office, store, office or other similar place of business in such jurisdiction or has therein a resident agent, representative, salesman on commission or employee, in all other cases the acceptance is deemed to be in the jurisdiction in which the company has its head office or principal place of business.

III. The company should be called upon to file a certified copy of the final assessment received from the Dominion Government.

IV. The revenue of companies whose business is only that of owning securities of other corporations, provided that such companies do not sell securities to or buy securities from the public other than their own shares or bonds, shall be computed excluding profits or losses resulting from

the sale of investments. A special rate of tax such as 1/20th of 1% as presently set forth in Order-in-Council 1988, amended by 2666 on November 4, 1932, to be levied against such profits.

V. In the case of corporations other than either investment trading corporations or those described in Suggestion IV above, the income received by companies having their head office in Quebec from securities of other companies incorporated in Canada should be free of tax.

VI. The Board of Appeals suggested under the heading of "Capital Tax" is also suggested under this heading.

Conclusion:

In conclusion it is particularly stressed that changes in the Act should tend in the direction that the basis of taxation and the methods of determining the tax liability should, as far as possible be statutory rather than discretionary. It is realized that it is impractical in the first instance to provide in the Act for all situations and circumstances which might arise, but it is suggested that whenever it becomes necessary to issue regulations, such regulations should be published and subsequently included, as provisions, within the Act itself. It is furthermore suggested that the revision of the taxing acts should not be approached from the angle of introducing further changes in the form and incidence of taxation, but a conscientious endeavour should be made to simplify existing laws after having determined sound principles and after having given consideration to conservative business practices.

Respectfully submitted,

THE SOCIETY OF CHARTERED ACCOUNTANTS
OF THE PROVINCE OF QUEBEC.

(Signed) Guy E. Hoult,
President.

THE DOMINION ASSOCIATION OF CHARTERED
ACCOUNTANTS

1937-38

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GENERAL NOTES

Matters of Interest to Members

The 1938 Annual Meeting of Association

As announced in the April issue of *THE CANADIAN CHARTERED ACCOUNTANT* the Thirty-Sixth Annual Meeting of The Dominion Association of Chartered Accountants will be held in the Hotel Nova Scotian, Halifax, August 22nd to 25th inclusive.

The members of the Institute of Chartered Accountants of Nova Scotia are hosts to the profession this year, and for some time the Entertainment Committee in Halifax has been completing arrangements to insure an enjoyable time for all members and their ladies making the trip to the Maritimes at this delightful time of year. Among the items on the programme, which is approaching its final form, are:

Monday, 22nd August—Meetings of the Executive Committee and of the Council.

Tuesday, 23rd August—Registration begins, meeting of the Council, the President's luncheon to Council members, and informal reception of the Nova Scotia Institute to the visiting members and their ladies.

Wednesday, 24th August—First general session, addresses of welcome by Provincial and Civic officials, the Council's and other reports, golf tournament and supper dance.

Thursday, 25th August—General session all day, discussion of professional matters, reading of technical papers, roundtable discussion of subject of current professional interest, luncheon at which the members are guests of the Nova Scotia Institute, annual banquet of Dominion Association.

A programme of optional entertainment for Friday and the week-end of August 27-28 is being arranged for those members who may wish to remain after the last general session of the meeting.

A copy of the programme will be reaching members well in advance of the annual meeting and will also be published in our July and August issues.

Our Contributors This Month

GEORGE R. G. BAKER was born in Toronto, of United Empire Loyalist stock; graduated from University of Toronto, and Osgoode Hall; engaged in the general practice of law until March, 1936, when he was appointed Secretary-Treasurer of The Land Mortgage Companies' Association of Ontario, and to the staff of The Dominion Mortgage and Investments Association.

ROGER NEALE CARTER, of Manchester, England, who writes on the administration of the income tax in Great Britain, is a distinguished member of the profession in the Old Land. He was admitted a member of the Institute of Chartered Accountants in England & Wales in 1893, elected to Fellowship in 1903, and was President of the Institute in 1936-37. He holds the degree of Master of Commerce from the Victoria University of Manchester and for some years was Lecturer in Accounting to the Faculty of Commerce of that University. With Adam Murray, he is author of "Murray and Carter's Income Tax," and is also author of "Advanced Accounts," and "Students' Guide to Executorship Accounts."

IRVIN T. HUNT was born and educated in Manitoba and taught public school in that province prior to entering the office of Millar, Macdonald & Co., chartered accountants, Winnipeg. He passed the final examination of the Institute of Chartered Accountants of Manitoba in 1934 and since then has been a member of the Audit Branch staff of the Manitoba Government.

International Congress on Accounting

As previously announced in these pages, the Fifth International Congress on Accounting will be held in Berlin, Germany, 19th to 24th September next.

As the Executive Committee of our Association is desirous of sending to the Congress in advance of the meeting a list of members of the Dominion Association who expect to be in attendance, all members who are planning to attend the Congress in Berlin are hereby asked to notify the Secretary-Treasurer of The Dominion Association of Chartered Accountants, 10 Adelaide Street East, Toronto, on or before 1st August.

GENERAL NOTES

Income Tax Collections by Districts

The following comparative statement of net collections by districts received during the fiscal years ending 31st March 1937 and 31st March 1938 is taken from *The National Revenue Review*, the monthly publication of the Department of National Revenue, Ottawa. A decrease from the previous year is indicated by an asterisk.

Districts	1936-37	1937-38	Increase or Decrease
Charlottetown .	\$ 872,984 53	\$ 970,278 58	\$ 97,294 05
Halifax	1,375,273 59	1,614,332 04	239,058 45
Saint John	910,940 18	1,100,727 72	189,787 54
Quebec	1,318,789 12	1,226,967 42	*91,821 70
Montreal	27,750,579 47	32,418,197 85	4,667,618 38
Ottawa	8,045,738 34	8,073,802 80	28,064 46
Kingston	327,474 35	270,446 93	*57,027 42
Belleville	443,590 49	614,810 14	171,219 65
Toronto	33,535,220 68	40,645,212 45	7,109,991 77
Hamilton	6,792,857 10	8,027,965 31	1,235,108 21
London	9,221,874 64	10,729,632 36	1,507,757 72
Fort William ..	262,849 52	358,576 27	95,726 75
Winnipeg	2,484,464 46	3,008,383 60	523,919 14
Regina	260,542 90	329,076 46	68,533 56
Saskatoon	148,852 30	208,444 61	59,592 31
Calgary	1,430,729 48	1,429,446 49	*1,282 99
Edmonton	419,975 46	493,181 48	73,206 02
Vancouver	6,738,986 37	8,819,373 99	2,080,387 62
Yukon	23,518 77	26,674 98	3,156 21
Total	102,365,241 75	120,365,531 48	18,000,289 73

Customs and Excise Revenue

Comparative Statement of Receipts for the Fiscal Years
Ending 31st March 1937 and 31st March 1938

	1936-37 (thousands of dollars)	1937-8 (thousands of dollars)	Increase over previous year
Customs duties—net	\$ 82,052	\$ 91,637	\$ 9,585
Excise taxes—net	145,599	174,451	28,852
Excise duties—net	45,971	52,162	6,191
Sundry Collections—net	722	796	74
	<u>\$274,344</u>	<u>\$319,046</u>	<u>\$44,702</u>

LEGAL DECISIONS

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Bankruptcy — Annulment of composition under Farmers' Creditors Arrangement Act — Secured credit — Petition under Bankruptcy Act

(Commercial Life Insurance Co. v. Strynadka)

Alberta Supreme Court, Appellate Division

Section 19 (2) of the *Bankruptcy Act* is not available to set aside a confirmed composition under the *Farmers' Creditors Arrangement Act*, 1934 (Can.), c. 53, on the ground of the debtor's failure to comply with the terms of composition or scheme of arrangement, on the application of a secured creditor. Such default, as an act of bankruptcy, can only be proceeded for by unsecured creditors, by petition under Part I of the *Bankruptcy Act*.—[1938] 2 D.L.R. 56.

Bankruptcy — Amendment of claims — Reorganization of brokerage corporation

(Trustee of Stobie, Forlong & Co. et al. v. Colwell)

Supreme Court of Canada

The amendment of proof of claim in matters of bankruptcy, especially in reorganization of bankrupt corporations, is within the discretion of the Court. A customer of a stock brokerage corporation which has gone bankrupt, who has proved his claim as an unsecured creditor for the conversion of his securities, on the basis of conversion at the time of bankruptcy, and received debentures and dividends under a reorganization plan, will not be permitted, after a lapse of seven years from the filing of his claim, to withdraw it and file an amended claim for a larger amount, founded on conversion at the date of actual sales which he later discovered. The Court in the exercise of its discretion will not permit amendment after the position of all the parties have been altered.—[1938] 2 D.L.R. 209.

**Bankruptcy—Election of trustee—Proxies by trust
company not votable**

(Re Ditchburn Boats & Aircraft (1936) Ltd.)

Ontario Supreme Court

The general manager of a corporation, authorized by its by-laws to act on behalf of the corporation, may vote proxies held by the corporation. Section 99 of the *Bankruptcy Act* gives a corporation the right to vote as a creditor only; but it is no part of the business of a trust company to gather unto itself proxies for the purpose of having itself appointed trustee in bankruptcy. The powers of a trust company under s. 18 of the *Loan and Trust Corporation Act*, R.S.O. 1937, c. 257, "to act generally as attorney or agent for the transaction of business," do not extend to acting as proxy for others, and its votes as proxy for creditors are illegal and cannot be counted in the election of a trustee.—[1938] 2 D.L.R. 518.

**Companies—Transfer of shares concurrent with payment—
Company struck from register.**

(Beaton v. Cooper)

Saskatchewan Court of Appeal

A contract for the sale of shares whereby the seller agrees that "after each succeeding payment has been made" he will transfer and assign to the purchaser the shares covered by such payment, time to be essence of the agreement, does not create a condition to make delivery of the shares concurrent with the payment of the purchase-price; the seller has a reasonable time to make delivery, and tender of the certificates within three days after payment has been tendered is a reasonable compliance with the terms of the agreement. The fact that the company issuing the shares was struck off the company register and was unable to register the transfer, but was later reinstated upon payment of the necessary fees required by law, is no defence to an action for the price of the shares. A seller of shares does not warrant the entry of the vendee's name in the company's stock register.—[1938] 2 D.L.R. 191.

Income tax—Payment to shareholders by way of return of capital—Whether taxable as income

(McConkey v. Minister of National Revenue)

Exchequer Court of Canada

A sum of money, accumulated for a period of years with the knowledge and approval of the Minister of National Revenue out of the exhaustion or depletion reserve built up for the purpose of replacing the capital assets of the company, which consisted solely of a wasting property, and paid out to shareholders while the company was still a going concern cannot be considered as a return of capital but must be treated as the distribution of a dividend and accordingly taxable as income.

Until a reserve fund is effectively capitalized it retains the characteristic of distributable profits; and a corporation not in liquidation can make no payment to its shareholders by way of return of capital except as a step in an authorized reduction of capital; any other payment made to its shareholders can only be made by way of dividing profits.—[1938] 1 D.L.R. 657.

[Editor's Note: A summary of the judgment of the Exchequer Court in the *McConkey* case was published in the December 1937 issue of THE CANADIAN CHARTERED ACCOUNTANT, pp. 458-460.]

Income tax—Transfer to evade—Antenuptial agreement

(Minister of National Revenue v. Molson)

Supreme Court of Canada

The transfer of securities by husband to wife in fulfilment of his obligation under an antenuptial agreement, valid as gift *inter vivos* under the Quebec law, is not a transfer to evade taxation under the *Income War Tax Act*, R.S.C. 1927, c. 97, s. 32, as will render the husband's estate liable for the tax on income derived from such securities; nor does the statute apply to transfers made before it came into force under its codification into the Revised Statutes of Canada. A saving clause in a repealing statute, or the provisions in s. 19 of the *Interpretation Act*, R.S.C. 1927, c. 1, that "liability accruing or incurred" under the repealed Act

shall not be affected by the repeal, will not cover a tax on income not due and unassessed at the time of repeal.—[1938] 2 D.L.R. 481.

(See previous reference to this case in the September 1937 issue of THE CANADIAN CHARTERED ACCOUNTANT, page 218.—Editor)

NOTE:—The *Western Vinegars* case, referred to on page 401 of the May issue, is reported also in the *Dominion Law Reports*, 1938, volume 2, page 503.

**Taxes—Mining Tax Act—Shareholders and company
as “co-owners”**

(*Flood v. Monargo Mines Ltd.*)

Ontario Court of Appeal

Shareholders are deemed “co-owners” with the company under the tax provisions of s. 19 of the *Mining Tax Act*, R.S.O. 1927, c. 28; and where a company, owning mining claims, has defaulted in the payment of the tax under the statute, a controlling shareholder who has paid a sum sufficient to repay the taxes advanced by another shareholder and is willing to repay any shortage and to divide the lands in proportion to their stock, is entitled to a vesting order for the company’s interest in the location notwithstanding prior payment of the taxes by the other shareholder.—[1938] 2 D.L.R. 460.

**Taxes—Unearned increment tax—Increased value—
Simultaneous transfers**

(*Registrar of North Alberta Land Registration
District v. Northern Agency Ltd.*)

Alberta Supreme Court, Appellate Division

The value of the land at the time of registration not the considerations of the transfers controls the Registrar in fixing the value of the land to ascertain the 5% tax on the increased value payable under s. 3(1) of the *Unearned Increment Tax Act* (Alberta). Where two transfers to the same land are presented for registration at an interval of two minutes apart, and there being no affidavit of value to the first transfer, held that the Registrar could not of his own motion find excess in value, for purposes of the tax, by the difference of the consideration of the first transfer and the sworn value in the second transfer.—[1938] 2 D.L.R. 434.

(Note: The following summary is taken from *Canada Law Reports*)

Income tax—Income accumulating in trust for the benefit of unascertained persons—Interest—Discretion of Court

(Peter Birtwistle Trust v. The Minister of National Revenue)

Exchequer Court of Canada

B., a Canadian citizen, in his lifetime transferred certain assets to the Trusts and Guarantee Co. Ltd. to be converted into cash and administered by it in accordance with the terms of an agreement entered into by them, which provided that after the expiration of 21 years following the death of B., the fund so established and all accumulations thereon should be paid to the Municipal Council of the Town of Colne in England, to be used by the said Council for the benefit of the aged and deserving poor of the said Town of Colne in such manner and without restriction of any kind, as shall be deemed prudent to the said Council. B. died on April 19, 1927.

The income from this fund was assessed for income tax under the *Income War Tax Act*, such assessment being confirmed by the Minister of National Revenue from whose decision the appellant appealed.

Held: That there is but one trust with two trustees, and the trust fund is being administered by the Canadian trustee, in Canada, where it must remain until 1948, and where the income is taxable.

2. That the persons who may in the future become beneficiaries of the trust fund are unascertained, and any interest of persons in the trust fund is a contingent one, and therefore the income is taxable as provided for in s. 11, ss. 2, of the Act.

3. That the income here accumulating is not the income of a charitable institution within the meaning of s. 4, ss. e, of the Act.

4. That s. 66 of the Act does not vest a discretionary power in the Court to forego interest on any tax recovered by a judgment of the Court.—[1938] Ex. C.R. 95.

[EDITOR'S NOTE: A summary of this judgment was published in the February 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT, and a copy of the full judgment is in the reference library of each Provincial Institute. The appellant has appealed also from this judgment to the Supreme Court of Canada.]

PROVINCIAL NEWS
BRITISH COLUMBIA

The final law examinations of the British Columbia Institute, comprising three papers, were held in Vancouver on 17th and 18th May.

The annual meeting of the Institute will be held on a date in June to be fixed at the May meeting of the Council. The business meeting will be followed by the usual golf match in the afternoon and dinner in the evening.

Three additional by-laws or amendments have been passed during the present year of the Council and will be presented for ratification, or otherwise, at the annual meeting. Two of these (designated 3b and 3c) deal with the functions and procedure of the Council. The other is an amendment to by-law 39.

SASKATCHEWAN

Regina—The local Chartered Accountants' Club held two meetings recently, one during April and the second in May. The former was held in the evening at the Kitchener Hotel, Regina, and took the form of a banquet. At the commencement Mr. J. A. Morton, C.A., President of the Club and chairman of the meeting, paid tribute to the late Mr. J. W. Rosborough, and a standing vote of sympathy was extended to the family.

Mr. T. E. Robinson, C.A., the Institute Vice-President, gave a brief review of the activities of the Legislation Committee and referred to certain amendments which had been passed at the last session of the Provincial Legislature relating to the Marketing Act, Income Tax Act and certain municipal legislation.

Opportunity was also taken at this meeting to have as honoured guests two members in the persons of Mr. A. Perring Taylor, C.A., and Mr. J. A. Taylor, C.A., both of whom at that time were shortly leaving the city. Mr. Perring Taylor, Deputy Provincial Treasurer, has now retired and will be leaving to take up residence in Vancouver in the near future. Mr. J. A. Taylor, Superintendent of Revenues, resigned from that position and left on April 6th, having accepted a very important position with a power utility company in Ohio.

Mr. G. C. Rooke, F.C.A., in a farewell address to both the guests, extended the Club's good wishes to them.

In speaking of Mr. Perring Taylor, Mr. Rooke made reference to the good work he had done while a member of the Institute, which he joined 29th May 1925, and referred particularly to his fine services as Librarian for the Institute and as a member of a number of committees. He also made reference to Mr. Perring Taylor as a public servant pointing out the high esteem in which he was held and the efficient manner in which he had discharged his duties.

In speaking of Mr. J. A. Taylor, Mr. Rooke mentioned that he was one of the younger members, having been admitted in December 1930. He was born in Moose Jaw and after becoming a chartered accountant was associated with the Dominion Power and Electrical Company at Estevan, later resigning and joining the Civil Service in Saskatchewan, being appointed Superintendent of Revenues. This position he held for a year when he was made an offer by the parent company in Ohio of the above mentioned utility company, which offer he decided to accept.

Mr. Rooke, expressing both the regret of the Club at losing these two members and its good wishes to both for the future, drew attention to the fact that Mr. Perring Taylor having now retired could be justly proud of his accomplishments and that Mr. J. A. Taylor had a wonderful future before him.

Among the outside visitors to the Club on this occasion were Messrs. H. H. Bamford, F.C.A., and T. R. Wilder, C.A., both of Moose Jaw.

The May meeting took the form of a luncheon at the Kitchener Hotel in honour of Mr. Harold S. Moffet, C.A., who was leaving shortly for Calgary to assume a position with the Trans-Continental Coach Lines, Limited.

Members of the Club expressed their high regard for Mr. Moffet's accomplishments during the short time he had been a member of the Institute, and wished him success in his new work.

Mr. J. Parton, F.C.A., of Winnipeg was an outside guest of the Club on this occasion.

PERSONALS

Announcement is made by F. J. Carter & Co., chartered accountants, that they have admitted to partnership William Tomlinson, chartered accountant. The firm name has been changed to Carter & Tomlinson with offices at 805 Royal Trust Building, 626 Pender Street West, Vancouver.

Announcement is made by A. W. Goldie & Co., chartered accountants, that they have admitted to partnership H. Austin Hunt, chartered accountant. The firm name has been changed to Goldie, Hunt & Co., with offices at 600 Broder Building, Regina, Saskatchewan.

Messrs. Robert Wilson & Co. and Messrs. Baker, Birnie & Co., announce that their accounting practices have been combined as from 1st May 1938 and will be carried on under the name of Wilson, Birnie & Seymour, chartered accountants, Room 309-10 Canadian Pacific Express Building, 215 St. James Street West, Montreal.

OBITUARY

The Late George Ussher Stiff

The Institute of Chartered Accountants of Ontario regrets to announce the death at Toronto on 18th May 1938, of George Ussher Stiff in his seventy-first year.

The late Mr. Stiff was senior partner in the firm of Stiff Bros. & Sime, Chartered Accountants, Toronto, and had been a member of the Ontario Institute since 1902. First elected to the Council in 1904, he continued to serve thereon until 1914. In recognition of service freely given in the interest and welfare of the Institute he was elected a Fellow in 1909, President in 1909-10 and 1910-11, and to Life Membership in 1913.

To his widow, brother and business associates the Institute extends sincere sympathy.

BOOK REVIEW
ESSAYS IN POLITICAL ECONOMY

(In Honour of E. J. Urwick)

Edited by H. A. Innis

(Published by University of Toronto Press, 1938, cloth, 244 pp., \$2.50)

This book is a collection of fourteen essays written by members of the Political Economy Department and former holders of the Maurice Cody Fellowship at the University of Toronto. It contains material of interest not only to the professional economist and political scientist but also to the general reader. Owing to the wide range of topics covered, there is no central theme with which the reviewer can deal. Even among those contributions which particularly appeal to the economist there are articles on pure theory, international trade, money and banking, economic history, and problems of the drought area in Western Canada.

For purposes of this review three essays have been selected as follows: *Overhead Costs, Time Problems, and Prices* by I. M. Biss; *The Origins and Development of Fascism* by L. I. Morgan; and *Staple Production and Canada's External Relations* by F. W. Burton. The above were chosen because they relate to different fields and appeal to various types of readers. All are indicative of the high quality of the volume as a whole.

Miss Biss deals with output and pricing problems which result in cases where the productive equipment is incapable of adjustment to meet changes in demand. Such problems arise mainly under two different sets of conditions: (1) when unforeseen fluctuations in demand occur, and (2) when variations in demand are anticipated. In the "long-run," under both types of circumstances, prices must cover all costs, otherwise operations will be discontinued. In the "short-run" the situation is more complex. If demand fluctuations are unforeseen and production is carried on under purely competitive conditions, the *entrepreneur* will adjust his output so that marginal "avoidable" costs equal marginal revenue. The same policy will be adopted under conditions of monopoly or imperfect competition, but the producer now has to face the problem of selecting the best combination of price and output. The situation is further complicated by the presence of alternate markets and, except in the case of monopoly, by the danger of "spilling the market." In the above considerations only "avoidable" short-run costs are relevant. When recessions in demand can be predicted, provision is made for them in the "long-run" calculations of *entrepreneurs*. Both unforeseen and foreseen variations in demand involve production for considerable periods of time at avoidable costs and prices lower than those to be expected in the "long-run." The entire analysis of this rather complicated subject is clear and concise.

Professor Morgan considers the origin of Fascism in Italy, Germany, and to a lesser extent, Spain. The root cause of the movement is to be found in the world's economic crisis. It starts as a petty middle-class movement and thus far has been facilitated by the failure of the Social-Democrats to secure and maintain political control. Various factions in the movement necessitate a dictator. The essential qualifications of leadership are "spell-binding and rank opportunism." The capitalist group, fearing a drastic swing to the left, throws its weight behind the dictator. The whole movement eventually becomes intensely national in character. Fascism is simply Undemocratic Capitalism, that is, a social system where the working-class is not

allowed to form its own economic organizations or to engage in independent political activity. The author contends that we may expect the spread of Fascism to other countries, including Great Britain, United States, and Canada, unless it is checked by Social-Democracy. With Professor Morgan's presentation of the subject the reviewer is in general accord. It may be argued, however, that Social-Democracy of the brand developed in Europe was a *cause* of Fascism. Furthermore, the movement depends much more on the character and ability of the leaders than the writer apparently is willing to admit. Unfortunately, in reading this article, one gets the impression that anybody who disagrees with Professor Morgan's economics and politics is, in his opinion, sadly deficient in intellectual capacity.

Mr. Burton's essay is one of the most readable in the series. It presents an interesting combination of economic theory, geography and history. Canada's dependence upon foreign trade and the inflexibility of her economy places her at the mercy of the policies of foreign governments. The need for external markets has always been and still is vital to Canada's economic prosperity. There has been little justification for the tariff either as a means of attempting to attain a measure of self-sufficiency or as a method of raising revenue with which to build railroads, which in turn were supposed to reduce transportation costs. (The political benefits derived from the railroads are not considered.) Mr. Burton contends that a solution to Canada's economic problems cannot be found apart from international assistance. Coöperation within the British Empire offers some hope, but the United States is not likely to abandon her policy of isolation in the near future. The writer concludes, somewhat pessimistically, that Canada's best policy is that of liberalism and moderation combined with the seeking of international coöperation.

Considering the variety of subjects covered in the articles and the evidence of a high standard of scholarship on the part of the contributors, *Essays in Political Economy* constitutes a valuable addition to Canadian literature.

M. K. INMAN.

University of Western Ontario
27th April 1938.

Terminology Department

As the Chairman of the Committee on Accounting Terminology had to do considerable travelling during April and May, the usual instalment of definitions of accounting terms does not appear this month.—Editor.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

The Securities and Exchange Commission of the United States appears to regard with disfavour the use in auditors' reports of the phrase "Subject to the foregoing . . ." when the intention of the auditor is to express positive disagreement. A member of that Commission in a recent article¹ cited a case in which a certain utility company, which had consistently been amortizing bond discount by charges against income over the terms of the bonds, suddenly wrote the unamortized balance of about \$5,000,000 off against a capital "surplus" created by an appraisal of its properties made by an affiliated concern. The accountants, in their report for prospectus purposes, described the transaction and its effects upon earnings and then certified to the statement "Subject to the foregoing comments." Before the registration certificate became effective this clause was amended to read "Except for the matters discussed in the foregoing comments." Later in the article the author said: "We do not want an opinion in a sort of cipher that would stump Francis Bacon himself . . . I think accountants should express their opinions in ordinary non-technical language and not in stereotyped phrases that few outside the accounting profession have the key to. 'Subject to the foregoing' will not suffice."

The Commission was presumably not constituted as an arbiter of accounting principle and auditing procedure but it is finding itself increasingly concerned with questions of accounting and it is likely to influence appreciably the practice of accountants in the United States.

* * *

An interesting theoretical point arises in connection with stock dividends received. The New York Stock Exchange while noting that current accounting practice in this regard is anything but uniform takes the position that stock dividends received may be credited to income account at any dollar value per share not greater than that

¹Robert E. Healey, "The Next Step in Accounting," *The Accounting Review*, Vol. XIII, p. 1.

at which they have been charged to earned surplus account on the books of the paying companies.² A theoretical approach would suggest not only this limitation but further, and more important, a proviso that the earned surplus out of which the dividend is declared shall have been earned *since* the original investment was made. This latter consideration is the dominant one in determining the *nature* of a stock dividend, that is to say whether it is income or merely realization of capital. In determining the *amount* of the dividend there should be taken into consideration not only the charge to earned surplus account by the paying company but also the market value of the dividend shares. Whichever of these two amounts is the smaller would seem to be the correct one at which to record the dividend on the books of the recipient. If the dividend shares are subsequently sold at a figure which diverges from this amount the difference represents a loss or gain on sale of investments and not an adjustment of income from investments.

* * *

PUZZLE

A three-volume edition of a learned work reposed undisturbed for a number of years on the bookshelf of a student (not an accounting student of course). When at last the volumes were removed from the shelf in the course of a search for a pipe cleaner it was found that a bookworm had bored a hole straight through from the first page to the last. The leaves were together three inches thick in each volume, and every cover was exactly one eighth of an inch thick. How far had the bookworm travelled?

* * *

Note on the "false proof" of last month's issue. A correspondent exposed the fallacy neatly by use of a simple arithmetical version as follows:

$$(-2)^2 = 4$$

$$(+2)^2 = 4$$

$$\text{Therefore } (-2)^2 = (+2)^2$$

$$-2 = +2$$

$$\text{and } 4 = 0$$

The fallacy is what is technically known as the "undistributed middle" and is very common in verbal reasoning.

²Report of the Special Committee on Stock Dividends, New York Stock Exchange.

e.g. Man is an animal; a monkey is an animal; therefore man is a monkey. In mathematics it takes the form of employing a process that is not uniquely reversible as though it were. In the algebraic form used in the "proof" last month the two members $(x-z)$ and $(y-z)$ are arithmetically equal but of opposite sign or quality. Their squares are equal. But the fact that the squares of two members or numbers are equal is not a proof that the members or numbers themselves are equal.

* * *

STUDENTS' ASSOCIATION NOTES

PROVINCE OF QUEBEC—Montreal

The Chartered Accountants Students' Society of the Province of Quebec is preparing now for its annual Tennis and Golf Tournaments; the worries of study and examinations are happily things of the past.

Competition should be most keen in the former sport because the F. W. Sharp trophy is again up for play and last year's winner Gordie MacNeil will have a job to hold it.

As for golf, while there are some budding Bobbie Joneses among us, there is a tendency to look upon this as a field day though not devoid of personal rivalry.

Our annual meeting and election of officers is to be held in June and at the same time the annual report will be presented.

* * *

COMPANY ACCOUNTS IN THE UNION OF SOUTH AFRICA

A correspondent recently sent to us a copy of the annual financial statements of a typical South African corporation. These related to a printing and publishing concern incorporated under the laws of the Union and took the form shown below.

STUDENTS' DEPARTMENT

H LIMITED BALANCE SHEET AS AT 31st MARCH, 1937

LIABILITIES	
I.—CAPITAL	
Nominal:	
£150,000 in 150,000 8 per cent. Cumulative Preference Shares of £1 each	
£200,000 in 200,000 Ordinary Shares of £1 each	
Issued:	
100,000 8 per cent. Cumulative Preference Shares of £1 each, fully paid	
200,000 Ordinary Shares of £1 each, fully paid	
II.—SURPLUS	
(a) Capital Reserve:	
As per last Accounts at 31st March, 1936	
(b) General Reserve:	
As per last Accounts at 31st March, 1936	
Amount appropriated, 18th June, 1936	
(c) Profit and Loss Appropriation Ac- count:	
Balance as per attached account..	

ASSETS	
I.—FIXED ASSETS:	
(a) Freehold Property:	
At Johannesburg and Cape Town, at cost	
(b) Machinery, Plant, Type, Metal, Fixtures and Furniture:	
At cost per books, less total depreciation to date	
(c) Motor Cars, Vans and Cycles:	
At cost per books, less total depreciation to date	
Total Fixed Assets	
II.—SUBSIDIARY COMPANY:	
Shares at Cost	
III.—NET FLOATING ASSETS:	
(a) Stocks on Hand, In Transit, In Bond and Work in Progress:	
As valued by the Directors or Managers in charge at each place	
(b) Book Debts and Publications:	
As per books	
Less Reserve	
(c) Cash and Bank Balances:	
On Current and Deposit Ac- counts, Sundry Trade Deposits, and Cash on hand	
Less—	
(d) Creditors:	
Preferent	
Trade and Loan Accounts....	
Subsidiary Company—Current Account	
Total Net Floating Assets ..	

I have audited the books and accounts of Messrs. H Limited for the year ended 31st March, 1937, and have obtained all the information and explanations I have required. In my opinion, the above Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs according to the best of my information, the explanations given to me, and as shown by the books. Proper books and records have been kept by the Company during the year. The figures in reference to the Company's Branches, incorporated in the above Balance Sheet, have been taken from accounts and returns certified by the Auditors at the Branches.

R.H.
Chartered Accountant, Auditor

H LIMITED		
GENERAL PROFIT & LOSS ACCOUNT AND PROFIT & LOSS APPROPRIATION ACCOUNT		
Dr.		Cr.
I.—PREFERENCE DIVIDEND—		
Dividend paid at the rate of 8 per cent. in respect of year to 31st March, 1937		I.—NET PROFIT FOR THE YEAR ENDED 31st MARCH, 1937—
		Profit of the Company for the year ended 31st March, 1937
II.—ORDINARY DIVIDEND—		
Dividend paid on 1st August, 1936 at the rate of 7 per cent. in respect of year to 31st March, 1936		II.—BALANCE OF PROFITS AT 31st MARCH, 1936—
Dividend (interim) paid on 1st February, 1937 at the rate of 8 per cent. in respect of year to 31st March, 1937		Brought forward from last Accounts
III.—INCOME TAX—		
Income Tax paid to 30th June, 1936		
IV.—GENERAL RESERVE—		
Amount appropriated at Annual General Meeting, 18th June, 1936		
V.—BALANCE OF PROFITS AT 31st MARCH, 1937—		
Carried to Balance Sheet		

R.H.
Chartered Accountant, Auditor

The most striking feature of the balance sheet in Canadian eyes is probably the treatment of current liabilities as a deduction from current assets and the extension of the difference as "Net Floating Assets." It will be noticed that H Limited is a holding company but that neither the accounts nor the auditor's report give the information with regard to the operations of the subsidiary which is required by s. 114 of the [Dominion] Companies Act 1934. The only reference to this matter occurs in the Directors' report which states that "Our subsidiary company traded in the period with satisfactory results." The "General Profit and Loss Account and Profit and Loss Appropriation Account" takes much the same form as did the "general statement of income and expenditure" submitted in compliance with s. 136 of the [Dominion] Companies Act prior to its repeal in 1934.

PROBLEMS AND SOLUTIONS

In this section a departure from the customary procedure occurs this month. The Author has selected a couple of problems from recent examinations in accounting set by the University of Cape Town for the degree of Bachelor of Commerce. He has prepared the solutions himself and he apologizes to any South African reader who may chance to come across these solutions for his ignorance of South African accounting idiom.

PROBLEM I.

Marchmont Manufacturers, Ltd., require the transport of their goods to and from the nearest station, three miles away. For this purpose they have hitherto kept their own motor lorry. The lorry is now worn out, and before investing in a new machine, the directors are considering whether they should not instead employ an independent contractor. The latter, who has a high reputation for reliability, has stated that he would be willing to provide lorries, drivers, etc. at the inclusive rate of 6/- per return journey.

You are requested to report on whether such an agreement would be advantageous to the Company.

From the Company's records, you find out the following data concerning the cost of keeping a lorry.

- (a) A suitable machine costs £350, and would last for 3 years, during which it would run 60,000 miles. This is also the distance that the hired lorries would be required to run.
- (b) Tax and Insurance amount to £36 per annum.
- (c) Repairs amount to £60 per annum.
- (d) The wages bill is £3.10. 0/- per week for the driver and 50/- for the labourers who assist him with loading, etc.
- (e) The fuel consumption is 6 m.p.g. (at 1/6d. per gallon).
- (f) Stores, oil, etc. cost £10 per annum.
- (g) The Company has already erected a garage at a cost of £300; no alternative use can be found for this building if a lorry is not kept.

Frame a suitable report to the directors.

SOLUTION

The Directors,
Marchmont Manufacturers, Ltd.
Gentlemen:

As requested by you I have made a study of the comparative cost of transportation by your company's own lorry and by that of an independent contractor. I am of the opinion that your company should continue to operate its own lorry since this will involve a cash outlay

of 4s. 8½d. per round trip of six miles (See Schedule attached) as compared with the figure of 6s. 0d. per round trip rendered by the independent contractor.

You will notice that amortization of the cost of the garage does not enter into the calculations for the reason that it does not represent an avoidable cash outlay.

Schedule of Cash Outlay on Operation of Owned Motor Lorry for Three Years (60,000 miles which is the equivalent of 10,000 return trips).

£2,354

PROBLEM 11.

The balance sheets of the two companies at 30th June, 1937 (date of amalgamation) were as follows:

ASSETS:

	Co. Ltd.	B. Co. Ltd.	A. Co. Ltd.	B. Co. Ltd.
Authorized and Issued Capital:				
100,000 £1 shares,			£14,500	£35,000
10/- paid	£50,000	—	9,716	23,655
10,000 fully paid shares of £10 each	—	£100,000	25,345	65,329
5% Debentures ..	—	50,000	—	15,000
Creditors	8,525	36,450	—	5,000
Bank Loan Account	—	15,000	12,564	32,356
General Reserve ..	5,000	—	—	2,616
Dividend equalization reserve ..	2,500	—	4,500	12,000
Employees' bonus fund	2,000	—	2,850	464
Profit & Loss Account	1,450	—	—	10,000
	£69,475	£201,450	£69,475	£201,450

- (a) The shareholders in A. Co. Ltd. to receive 4 fully paid ordinary shares of £1 each and 3 fully paid £1 preference shares in A. B. & Co. Ltd. in exchange for every 10 shares held in A. Co. Ltd.
- (b) The shareholders in B. Co. Ltd. to receive 7 fully paid ordinary shares of £1 each in A. B. & Co. Ltd. in exchange for every

THE CANADIAN CHARTERED ACCOUNTANT

one share held in B. Co. Ltd., and the debentures issued by B. Co. Ltd. to be discharged at a premium of 5% by the issue of 5% debentures in A. B. & Co. Ltd. at par, the patent rights being considered to have no value, and the goodwill account to be subject to adjustment.

Show, by drafting the more important accounts in the ledgers of the old companies, and preparing the opening balance sheet of A. B. & Co. Ltd. as at 30th June, 1937, how the change is carried out.

SOLUTION

(1) Books of A. Co. Ltd. (All entries as at June 30, 1937).

REALIZATION ACCOUNT.

Land and Buildings	\$ 14,500	Creditors	\$ 8,525
Plant and Machinery	9,716	Employees' Bonus Fund	2,000
Stocks	25,845	A. B. and Co. Ltd.	70,000
Debtors	12,564		
Investments	4,500		
Bank Current Account	2,850		
Transfer to Shareholders' Account—Gain on Liquidation ..	11,050		
	<u>\$80,525</u>		<u>\$80,525</u>

SHAREHOLDERS' ACCOUNT

Shares in A. B. and Co., Ltd.		Share Capital (100,000 shares) \$	50,000
40,000 Ordinary of \$1 each .	\$ 40,000	General Reserve	5,000
30,000 Preference of \$1 each	30,000	Dividend Equalization Reserve .	2,500
		Profit and Loss Account	1,450
		Realization Account	11,050
	<u>\$70,000</u>		<u>\$70,000</u>

A. B. AND CO. LTD.

Realization Account	\$ 70,000	Shares—	
		40,000 Ordinary	\$ 40,000
		30,000 Preference	30,000
	<u>\$70,000</u>		<u>\$70,000</u>

ORDINARY SHARES IN A. B. AND CO. LTD.

A. B. and Co. Ltd.		Shareholders' Account	\$ 40,000
40,000 shares of \$1	\$ 40,000		
	<u>\$40,000</u>		<u>\$40,000</u>

PREFERENCE SHARES IN A. B. AND CO. LTD.

A. B. and Co. Ltd.		Shareholders' Account	\$ 30,000
30,000 shares of \$1	\$ 30,000		
	<u>\$30,000</u>		<u>\$30,000</u>

(2) Books of B. Co. Ltd. (All entries as at June 30, 1937).

REALIZATION ACCOUNT

Land and Buildings	\$ 35,000	Creditors	\$ 36,450
Plant and Machinery	23,655	Bank Loan Account	15,000
Stocks	65,329	A. B. and Co. Ltd.	122,500
Goodwill	15,000	Transfer to Shareholders' Account—Loss on Realization ..	20,000
Patent Rights	5,000		
Debtors	32,386		
Bills Receivable	2,616		
Investments	12,000		
Bank Current Account	454		
Premium on Debentures Payable	2,500		
	<u>\$193,950</u>		<u>\$193,950</u>

STUDENTS' DEPARTMENT

SHAREHOLDERS' ACCOUNT

Profit and Loss Account	\$ 10,000	Share Capital	\$100,000
Realization Account	20,000		
Shares in A. B. and Co. Ltd.:			
70,000 Ordinary of £1 each .	70,000		
	<u>£100,000</u>		<u>£100,000</u>

5% DEBENTURES PAYABLE

5% Debentures of A. B. and Co. Ltd.	\$ 52,500	Balance	\$ 50,000
		Realization Account—Premium of 5%	2,500
			<u>£100,000</u>

A. B. AND CO. LTD.

Realization Account	\$122,500	5% Debentures	\$ 52,500
		Shares—70,000 Ordinary	70,000
			<u>£122,500</u>

5% DEBENTURES OF A. B. AND CO. LTD.

A. B. and Co. Ltd.	\$ 52,500	5% Debentures Payable	\$ 52,500
			<u>£52,500</u>

ORDINARY SHARES IN A. B. AND CO. LTD.

A. B. and Co. Ltd.	\$ 70,000	Shareholders' Account	\$ 70,000
70,000 shares	<u>£70,000</u>		<u>£70,000</u>

(3) A. B. and CO. LTD.

BALANCE SHEET AS AT JUNE 30, 1937.

ASSETS		LIABILITIES & CAPITAL	
Current Assets		Current Liabilities	
Bank Current Account	\$ 3,314	Creditors'	\$44,975
Investments	16,500	Bank Loan	15,000
Bills Receivable	2,616	Employees' Bonus	
Debtors	44,950	Fund	2,000
Stocks	90,674		<u>\$61,975</u>
	<u>\$158,054</u>	Funded Debt	
Fixed Assets		5% Debentures. ..	52,500
Land and Buildings	49,500	Share Capital	
Plant and Machinery	33,371	Authorized	\$200,000
	<u>82,871</u>	Issued: 30,000 Preference shares of £1 each	30,000
Goodwill	13,550	110,000 Ordinary shares of £1 each	110,000
			<u>£254,475</u>
	<u>\$254,475</u>		

NOTES: (1) The goodwill is computed thus:

Price paid for net assets of A. Co. Ltd.	\$ 70,000	
Book worth of net assets of A. Co. Ltd.	58,950	£11,050
	<u></u>	
Price paid for net assets of B. Co. Ltd.	122,500	
Book worth of net assets of B. Co. Ltd.		
(exclusive of goodwill and patent rights)	120,000	2,500
	<u></u>	<u>£13,550</u>

- (2) It is assumed that the "Investments" are held as current assets and valued at current market quotations.
- (3) No attempt has been made to set out the balance sheet in the form used in South Africa.





